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Print Edition September 15th 2007

On the cover
For all General Petraeus's spin, Iraq is still a violent mess. That is why America should not leave yet: leader

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Politics this week

Sep 13th 2007
From The Economist print edition

Getty Images

General David Petraeus delivered his keenly awaited report to Congress on the progress of the "surge" of troops to Iraq. The military commander did not produce any surprises in his two appearances, before the House and Senate, and reported steady progress in Iraq's security situation. George Bush seemed ready to follow through on the general's suggestion that the 30,000 extra troops deployed to Iraq this spring could be withdrawn by next summer. The Democrats, and one or two Republicans, argued it was too little, too late. See article

The **Democrats** took part in another televised debate, which, for the first time ever in such a forum, was conducted in Spanish. Broadcast from Miami on the Univision Spanish-language channel, the questions were translated for the presidential candidates through earpieces. They gave their answers in English.

California's Republicans held their state party convention. Governor Arnold Schwarzenegger addressed the party faithful and said they, like he, must move to the pragmatic centre if they were to escape the doldrums in the heavily Democratic state. "We are dying at the box office," lamented the former film star.

A longer stretch

Manuel Noriega completed a 15-year stint in an American prison for drug-trafficking. But **Panama's** former dictator remained in jail pending his appeal to avoid extradition to France to serve a further ten years. See article

Sir John Compton, one of the Caribbean's most outstanding leaders, died at the age of 82, after suffering a stroke in May. He served as prime minister of the former British colony of **St Lucia** from 1964 until its independence in 1979, and again from 1982 until his "retirement" in 1996, before being swept back into power once more last December.

After one of the bloodiest presidential election campaigns in **Guatemala's** history, Otto Pérez Molina, a former general, looked set to face a run-off against Álvaro Colom, a centre-left businessman, in the second round.

More talk on sanctions

Frustrated at the delay since the deadline for **Iran** to comply with UN Security Council instructions to suspend uranium and plutonium work expired in May, America invited its three European partners plus Russia and China to a meeting on September 21st to consider new sanctions. See article

The **Israeli** air force apparently bombed a target in **Syria**, but neither the Israelis nor the Syrians disclosed what it was. The Syrians said Israel wanted to torpedo any possibility of peace talks. Meanwhile, rockets fired from the **Gaza Strip** wounded scores of soldiers inside Israel. See article

Morocco's conservative but secular-minded Istiqlal party won a general election, narrowly beating the Islamists' Justice and Development Party, which gained less ground than expected. The turnout was only 37%. In any event, King Muhammad VI will continue to call the shots.

The World Health Organisation confirmed an outbreak of the deadly Ebola virus in the Kasai province of **Congo**. At least 166 people are known to have died of the disease so far.

Pius Ncube, an outspoken critic of **Zimbabwe's** President Robert Mugabe, resigned as the Catholic Archbishop of Bulawayo after a scandal. In July the state-run media aired photographs of what they claimed was the archbishop in bed with a married woman. See article

Shinzo bows out

Shinzo Abe resigned as **Japan's** prime minister, just a year after taking office. Mr Abe's Liberal Democratic Party suffered a disastrous electoral defeat in the upper house of the Diet (parliament) in July. But Mr Abe, who then entered hospital, blamed his departure on his inability to reach a compromise with the opposition to allow the extension of anti-terrorism measures. The front-runner to succeed Mr Abe is Taro Aso, the party's secretary-general and a former foreign minister. See article

AFP

Nawaz Sharif, a former prime minister of **Pakistan** overthrown in a coup in 1999 by General Pervez Musharraf, now the president, made a fleeting return from exile to the airport near Islamabad. Although the Supreme Court had declared he had an “inalienable” right to return to the country, he was charged with corruption on landing and packed off to Saudi Arabia, to where he was exiled in 2000. See article

An earthquake of magnitude 8.4 struck off the Indonesian island of **Sumatra**, sparking fears of a tsunami. There were several strong aftershocks, and reports of considerable damage on Sumatra, but the tsunami alerts were soon lifted.

A court in the **Philippines** found Joseph Estrada, president until 2001, guilty of corruption, and sentenced him to life imprisonment. He has always maintained the case is politically inspired and said he would appeal. See article

The army-backed government in **Bangladesh** eased some of the restrictions on political activity it imposed in January. Parties may reopen their offices, but not hold public meetings. The leaders of both the main parties are in detention facing corruption charges.

Putin's pick?

Russia's president, Vladimir Putin, selected a surprise new prime minister, Viktor Zubkov, a financial-crimes investigator whom he worked with in St Petersburg in the 1990s. Mr Zubkov replaces Mikhail Fradkov, who resigned “to give Russia's president full freedom of decisions, including staff.” Analysts had expected the new prime minister to be Mr Putin's choice as his own successor, but few think it will be Mr Zubkov. See article

Russia tested a giant fuel-air bomb that its army claims to be the world's biggest non-nuclear explosive device.

Turkish police found and made safe a big van loaded with explosives in central Ankara. Similar vans were used in bombings in Istanbul in November 2003.

A new case of **foot-and-mouth** disease was confirmed in Britain, just days after the all clear was given following a small outbreak in Surrey, the location of the latest case. Once again, farmers were banned from moving cattle.

Reuters

The **European Commission** dropped its plans to require Britain and Ireland to phase out the use of imperial weights and measures, such as pints and pounds, by 2009. The commission said it wanted to respect British and Irish culture and traditions.

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Business this week

Sep 13th 2007
From The Economist print edition

After lots of cajoling from Saudi Arabia, OPEC's members agreed to increase their output of oil by 500,000 barrels a day, the first official rise in two years. The cartel hopes the increase in supply, albeit very small, will signal that it is doing something to contain **oil prices**, which nevertheless continued trading at record highs after the agreement. See article

Hank Paulson warned that reverberations from the recent turmoil in the **credit markets**, caused by defaults in America's subprime mortgage market, would be felt for some months. America's treasury secretary reiterated there were no easy fixes to shore up confidence. He was speaking as investors continued to speculate that the Federal Reserve would cut the Federal funds rate by up to 50 basis points at its next meeting.

With a reduction in interest rates likely, the **dollar** fell to a new low against the **euro**, passing the $1.39 mark for the first time on September 12th. See article

The subprime shake-out

It was another bad week for **Countrywide Financial**. America's biggest private mortgage-lender saw its share price slide following a report that it was short of money and negotiating a second cash infusion (Bank of America bought a $2 billion equity stake in it last month). Earlier, the company said it would cut up to 12,000 jobs, or 20% of its workforce, because it expects mortgage volumes to fall by a quarter next year.

It emerged that Joseph Lewis, an investor with holding companies in the Bahamas and Florida, has become the biggest shareholder in **Bear Stearns**, building a 7% stake in recent weeks. It was the meltdown of two of the investment bank's hedge funds that precipitated the crisis in the credit markets (its share price has dived by 30% since July). Mr Lewis made his name during the run-up to Britain's ejection from Europe's exchange-rate mechanism in 1992, when he bet against the pound. See article

More hedge funds reported declines for August. Among them, the **Global Alpha** fund run by Goldman Sachs, which made losses in carry trades and equities and fell by 22.5%.

Mohamed El-Erian decided to quit his job as the chief executive of Harvard University's $35 billion endowment fund, initiating the second search in less than two years for someone to fill the position. Mr El-Erian is returning to Pimco, an investment firm, where he is being tipped to eventually replace Bill Gross as manager of the world's biggest bond fund.

Satisfaction guaranteed?

America and China held a summit on **product safety** in Washington. In what was described as a “co-operative effort”, China agreed to eradicate the manufacture of toys containing lead paint and to co-ordinate policies with America on safety standards for exports. Meanwhile, America's Senate hauled in the bosses of Mattel and Toys “R” Us to discuss the recent recalls of **Chinese-made toys**.

NTP, a patent-holding company, filed a lawsuit against four mobile-phone operators in the United States, including Verizon Wireless, alleging they had infringed on several **patents** related to wireless e-mail. Last year, NTP reached a $612.5m settlement with Research in Motion after a lengthy dispute that threatened to disrupt RIM's wireless BlackBerry service.

China's inflation rate leapt again, to 6.5% in August (year-on-year), up from 5.6% in July. The news caused Chinese share prices, which were resilient during the turbulence in financial markets, to wobble. Almost all the rise was accounted for by surging food prices, particularly pork following the outbreak of a disease lethal to pigs. See article

Russia's booming economy helped **Severstal**, a steelmaker, increase its net profit in the first half of 2007 by 135%, compared with a year ago, to almost $1 billion. The company also outlined a plan to spend $6 billion over the next few years on its steel mills.

The average cost of employer-provided family **health insurance** in America increased to $12,106 this year (of which workers pay $3,281), according to an annual report from the Kaiser foundation. Although the rate at which health premiums are rising has slowed over the past few years, they are 78% higher than in 2001. The survey found that 59% of employees were covered by company health-benefits, down from 65% in 2001.

The wrong direction

Payroll **employment** fell by 4,000 in America last month, the first drop since August 2003. Although nominally a small decrease, America's fast- growing population means it should be recording increases. The news perturbed most economists, who had expected the figure to rise; some thought it a harbinger of a slowdown. Around 22,000 jobs were lost in construction. See article

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KAL's cartoon

Sep 13th 2007
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Illustration by Kevin Kallaugher

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The Iraq war

Why they should stay

Sep 13th 2007
From The Economist print edition

For all General Petraeus's spin, Iraq is still a violent mess. That is why America should not leave yet

AFP

Get article background

POLITICS, said the late John Kenneth Galbraith, is the art of choosing between the disastrous and the unpalatable. The problem for America in Iraq is that it is agonisingly difficult to tell which is which.

General David Petraeus, America's senior commander in Iraq, and Ryan Crocker, its ambassador, went to Capitol Hill this week to tell Congress that bringing the troops home too soon would result in disaster. The general took along a flipchart of tables purporting to show that the “surge” of recent months was beginning to work (see article). The ambassador said he could not guarantee success but that if America gave up now the consequences would be massive human suffering, the intervention of regional states and gains for Iran and al-Qaeda.

More tunnel, little light

This newspaper was not wowed by either man. The spin General Petraeus put on the military achievements of the surge exaggerated the gains. Mr Crocker's claim to see a spirit of sectarian reconciliation bubbling just beneath the surface of Iraq's stalemated politics was even less convincing. But on one point Mr Crocker was surely right. If America removes its forces while Iraq remains in its present condition, the Iraqi future is indeed likely to be disastrous. For that reason above any other, and despite misgivings about the possibility of even modest success any time soon, our own view is that America (and Britain) ought to stay in Iraq until conditions improve.

A vote for staying does not mean that the leavers have no case. They made a powerful one this week. Most Democrats and a growing band of Republicans say that America has lost its ability to shape the politics of Iraq. By keeping its army on, ostensibly to hold the ring, America merely saves Iraq's Shia majority from the need to come to terms and share power with the disaffected and disfranchised (or so they feel) Sunni minority. It is possible that Iraq will never come good. It may eventually split apart. By his insistence on staying and making only token troop reductions as his presidency counts down, George Bush just postpones the inevitable. Meanwhile, American soldiers die for no good cause.

It can also be argued that the disaster Mr Crocker says will befall Iraq if America leaves has happened already. America's military presence has not prevented massive human suffering. At least 100,000 civilians have already been killed in an orgy of sectarian killing. Several million have already been forced

out of their homes. Regional states have already intervened by proxy. America's invasion has given al-Qaeda a new cause, battlefield and haven. And—irony of ironies—the best foreign friend of the Shia-led government that the American army props up in Baghdad is probably not the United States but Iran, America's great regional adversary.

Iraqis themselves are understandably disillusioned and hostile. As General Petraeus took his flipchart to Capitol Hill, the latest BBC/ABC News poll reported that the proportion of Iraqis who want America to leave at once had risen from 35% to 47% since February. More than two out of three think the surge has made things worse, 85% say they lack confidence in the American or British forces and 57% (93% of Sunnis) consider attacks on them acceptable.

On the security front, the best bit of news General Petraeus had for Congress is that local sheikhs in some mainly Sunni provinces such as Anbar, west of Baghdad, have stopped fighting alongside al-Qaeda and are now co-operating with American forces. But these Sunni tribesmen are at best fair-weather friends who do not trust and are not trusted by the government in Baghdad. Their decision to co-operate with America for the time being has had little impact on the sectarian killing and cleansing in mixed areas. General Petraeus says that by embedding American troops in violent neighbourhoods his surge has reduced sectarian killing by more than 45% since December. But even if his numbers are right that is just a kink in a graph of killing that has risen for most of the past four years.

If the case for staying depended on extrapolating from the modest gains the general claims for his surge, it would be a weak one. The strong case is that if America leaves, things will get even worse. This can only be a guess, but it is more plausible than the alternative guess that America's going will nudge Iraq in the right direction. In the past two years, violence has tended to decline where American troops are present and to rise in the places they leave. There is no doubt that some Shia militias want to rid Baghdad of its Sunnis and that American troops are for now the only thing stopping them. Contrary to what foreigners think, most Iraqis say they oppose partition: in the BBC/ABC poll, 62% said Iraq should have a unified government and 98% said it would be a bad thing for the country to separate on sectarian lines.

Not a must, just an ought

In the Senate this week, the Democrats' Joe Biden predicted that the American people would not support an indefinite war whose sole remaining purpose was to prevent the situation in Iraq from becoming even worse. He may be proved right. Asking Americans to squander more lives and money becomes harder and harder as the prospect of an Iraqi political settlement appears to recede. It is possible that within a year or 18 months a non-sectarian Iraqi army will be able to do much of the work the Americans do now. Or maybe the prospect of a new president in Washington in 2009 will concentrate the minds of the squabbling politicians in Baghdad. On the other hand, many previous hopes, such as those inspired by Iraq's first free elections of 2005, failed to bear fruit.

If America could choose again, it would not step into a civil war in Mesopotamia. But there are worse reasons than preventing a bloodbath for a superpower to put its soldiers at risk. Having invaded Iraq in its own interest—to remove mass-killing weapons that turned out not to exist—America owes something to Iraq's people, a slim majority of whom want it to stay. It is hard to know how Iraq can be mended. At some point it may become clear the country has sunk so low it is simply beyond saving. But it is not possible to be sure of that yet.

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Pakistan

The wrong direction

Sep 13th 2007
From The Economist print edition

Why America should push General Musharraf harder towards democracy

Reuters

Get article background

NAWAZ SHARIF was an appalling prime minister of Pakistan. He ran the place so badly from 1990-93 and 1997-99 that when General Pervez Musharraf overthrew him in a military coup, many people both inside and outside the country were rather relieved to see him go.

It seems odd, then, to claim that Mr Sharif is crucial to Pakistan's democratic future. It is, nevertheless, true. Despite his personal shortcomings, Mr Sharif represents something without which democracy cannot thrive—a real political movement with popular support. By expelling him from the country on September 10th within hours of his return from exile, General Musharraf has demonstrated that he is not serious about restoring democracy.

America seems untroubled by this. Two days after Mr Sharif's expulsion, a high-level American delegation turned up in Pakistan, and a spokesman described the expulsion as “an internal matter”. That's wrong. Whether Pakistan moves back to democracy, or is condemned to authoritarianism, is of great interest to America, and the rest of the world.

Deal time

In contrast with Mr Sharif, General Musharraf has in some ways been an impressive leader. He has managed to stay in power and hold the politicians at bay for eight years. Technically, he restored democracy in 2002, but he has rigged elections to keep serious opponents out of office. He ignored the Supreme Court's ruling that he should allow Mr Sharif back into the country. Opinion polls show that a growing majority of Pakistanis want him out, but by persuading America that he is holding the line against Islamist extremists he has won money and diplomatic support that have helped him hang on to power.

Yet things are getting difficult for the general (see article). A presidential election is due in the next couple of months; a parliamentary one by January. Last month he was about to declare a state of emergency, but a call from Condoleezza Rice, America's secretary of state, stopped him. He may explore that avenue to keeping his job again; or he may try to do a deal with Benazir Bhutto, the only other Pakistani political leader who matters, who is also in exile. She is demanding immunity from prosecution, the lifting of a ban on prime ministers serving a third term, the curbing of the president's powers to dismiss governments and the establishment of a caretaker government.

Would such a cosy arrangement between the general and the politicians be good for Pakistan? That depends on its terms. A deal that made a return to democracy possible by giving the army a stake in government but at the same time insisting that General Musharraf take off his uniform if he wants to be president would be worth doing. But a deal that divides power between the general and Miss Bhutto and deprives Pakistanis of the chance to determine their own future would not. And that, Mr Sharif's expulsion suggests, is what the general has in mind.

America is right to believe that a stable Pakistan is crucial both to regional peace and to securing the world against terrorism. But the only way to discourage Islamist extremism in Pakistan in the long run is through democracy. Election after election has shown that, except in some pockets of the country, Pakistanis do not vote for extremist parties. Islamists flourish when Pakistan is under military rule. That is why a return to democracy would be better both for Pakistanis and for the rest of the world; and why America needs to push the general harder in the right direction.

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Japan

The trouble with one-party rule

Sep 13th 2007
From The Economist print edition

After Shinzo Abe's resignation, Japan needs more than just a new prime minister

Reuters

Japan's politics

NOTHING in Shinzo Abe's occupation of the Japanese prime minister's office became him like the leaving of it: he made a mess of that too. But his departure on September 12th should be an occasion for more than lamenting his hapless year in office. The trouble is not one lousy prime minister but a political system that no longer works. The reign of Mr Abe's starry predecessor, Junichiro Koizumi, helped disguise this failure. But he, not Mr Abe, was the aberration.

Ill health may have precipitated the present crisis by forcing Mr Abe's final blunder: the poor timing of his resignation. But thanks to a sorry saga of his cabinet's incompetence, corruption and ill-fortune (see article) his poll ratings have been plumbing new depths for most of the year. At the end of July voters delivered the most damning of verdicts on his tenure, with a crushing defeat for his Liberal Democratic Party (LDP) in the upper house of the Diet, or parliament, where, for the first time since 1955, it is no longer the biggest party. In the past Japanese prime ministers have fallen on their metaphorical swords for much less. Yet he refused to resign. He then bought himself a little time by shuffling his cabinet, bringing in some LDP heavy-hitters who recalled the party's history of corrupt faction-ridden politicking, but at least, in the public eye, went some way to filling the government's competence deficit. He opened parliament, attended a regional summit in Sydney and then made a big policy speech on September 10th.

Two days later he stood down on the flimsiest of excuses: that Ichiro Ozawa, leader of the main opposition Democratic Party of Japan (DPJ), had refused to meet him to discuss a compromise over extending important anti-terrorism legislation. If Mr Ozawa did indeed refuse a meeting, it should surely have been taken merely as one skirmish in a campaign—for extension of the law—that Mr Abe regards as vitally important for Japan, rather than as a pretext for surrender.

Mr Abe is right that the lapsing of the law, which would entail Japan's calling off its operations refuelling ships in the Indian Ocean for the American-led campaign in Afghanistan, would damage Japan's international standing. But his staking his position on the issue highlights four big problems facing the Japanese electorate. The first is that too many LDP leaders, including Mr Abe and his most likely successor, Taro Aso, are obsessed with Japan's international stature and have lost touch with voters. They want to amend the pacifist constitution so that Japan can play a role in the world commensurate with its economic might. Voters are more interested in the economic might itself, and what it could do for them.

That is the second problem. Mr Koizumi's flair and common touch enabled him to sell voters a bill of goods which, on closer inspection, they do not like. His liberalising, market-friendly reforms will, if followed through, do much to sustain Japan's recent economic revival. But in the short term they are bringing pain to many areas. Unlike Mr Abe, Mr Koizumi timed his departure well.

Third, the DPJ's ability to stall and ultimately thwart the anti-terror legislation is not a temporary phenomenon. The next upper-house elections are six years away; it may be 12 before the LDP wins its majority back. After a Koizumi-inspired landslide in the 2005 lower-house elections, the LDP can carry on governing. But Mr Ozawa has a stranglehold.

Enough shuffling: time for a new deck

That would not matter so much if he led a party that might form a credible government. He does not: indeed, he himself does not want to be prime minister and is in poor health. The fourth big problem is the lack of a serious opposition. The DPJ is less a coherent party than a job lot of competing factions: rather like the LDP, in fact, but without the experience of more than 50 years of nearly uninterrupted power.

That one party has held sway for so long is of course itself a symptom of the sickness affecting Japanese politics. That is why many in Japan are hoping that the present mess does not, as usual, produce merely a factional compromise around an uninspiring new prime minister. Mr Koizumi is gone. But some of his followers are still around, frustrated by the return to the bad old days. They are mirrored by young Turks in the DPJ. For years idealists have dreamed of a realignment in Japanese politics, away from factional wheeler-dealing and towards true policy-based competition. In the present climate, hostile to Mr Koizumi's legacy if not the man himself, such a reformist grouping would have its work cut out. But the disarray of the big parties is such that it is surely worth a try.

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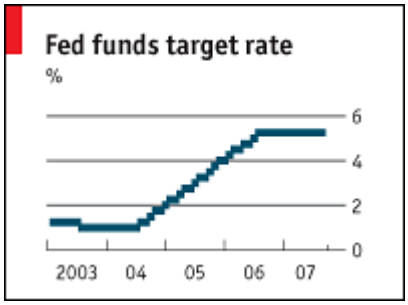
America's economy

It ain't easy

Sep 13th 2007
From The Economist print edition

It is dangerous for the markets to expect too much from the Fed



LAST month's jobs figures were depressing but useful: they clarified what the Federal Reserve needs to do when it meets on September 18th. Not only did the American economy shed 4,000 jobs in August (rather than gaining some 100,000 as most forecasters had predicted), but revisions to earlier figures showed that the pace of employment growth has been slowing sharply for several months. The numbers suggest that America's economy was sputtering well before the credit crisis.

America needs to create at least 100,000 jobs a month merely to absorb the growing working population. Now that the growth in employment seems to have stalled, the economy looks vulnerable. Add a credit crunch on top and the risks of a sharp slowdown, even a recession, are uncomfortably high. With inflation under control, the country's central bankers clearly ought to counter that risk by lowering their benchmark interest rate.

But there's a further danger, which America's central bankers need to watch out for. The pressure is building on them to sort out the problems in both the economy and the markets, and to do it soon. Listen to the clamour for a rate cut from investors and—more ominously—from some of America's politicians, and it is clear that many people expect far too much from the Fed.

In the short term, lower interest rates will not achieve all that much. Given that the central bankers do not know exactly how weak the economy is (the jobs figures, although important, are only one piece of evidence), let alone what damage the credit crunch will wreak, it would be irresponsible of them to slash the Fed funds rate. Any responsible rate cut will solve the problems of neither the markets nor the economy.

Start with the financial markets. Lowering the benchmark price of money will make other assets more attractive. It will counter investors' risk-aversion by reducing the odds of a truly nasty economic meltdown. But cheaper money will not, by itself, remove the source of the recent turmoil: worries about who holds the losses from the sub-prime mess and the uncertainties over banks' balance sheets. Assuaging those concerns will take time—time to work out what illiquid securities are worth, who bears the ultimate losses and how much capital banks will need to clear up the mess. A Fed funds rate at 4.75% or 5%, rather than today's 5.25% will make that process easier, but it will not make it painless.

Nor will a moderately lower Fed funds rate do much to stop the economy from slowing. It normally takes months for interest-rate changes to affect spending. And it may take even longer now because one of the most direct routes from lower interest rates to more spending may be clogged: a disproportionate share of the effect of lower interest rates on overall spending comes through housing, and with house prices falling amid a glut of unsold homes, that channel looks as if it will be weak. The effect of a gloomy housing market will be offset by strong corporate balance sheets and the falling dollar (see article) but the mechanism that cushions a slowdown may work less efficiently than it has in the past.

An opening bid

Given these uncertainties, next week's interest-rate decision is no more than the Fed's opening bid. To the economy, it matters little whether the bankers cut by a quarter or half point. If the slowdown is serious, more cuts will be needed. If it is not, the loosening can, and should, be reversed.

By rights, Wall Street should react only modestly to the size of the cut. But history suggests it may not. In September 1998 the Fed cut interest rates by a quarter point during the turmoil that followed the

implosion of Long Term Capital Management, a hedge fund. Disappointed at such caution, financial markets plunged, prompting the central bankers to pile on more rate cuts within weeks; a loosening that, with hindsight, was unnecessary.

The parallels are not perfect (the economy today shows clearer signs of weakness), but the lesson of 1998 is that the Fed needs to stand up to the markets. It should be guided by the economics and stick to its guns—that is, on September 18th it should cut the funds rate by a quarter point, to 5%, and cut further later only if that is what the economy demands.

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OPEC

Sheikh up

Sep 13th 2007
From The Economist print edition

The cartel is back in control of the oil price—for the time being

Rex Features

Get article background

BY BOOSTING their output of oil for the first time in two years, the members of the Organisation of the Petroleum Exporting Countries this week finally signalled that the oil price, at nearly $80 a barrel, has gone high enough. This time last year, by trimming its output, OPEC indicated that it did not want the price to fall below $60 a barrel. Will the cartel be able to keep the oil price confined between this lofty floor and even higher ceiling—and if so, what is the outlook for the world's energy supply from OPEC's new penthouse?

Abdullah al-Badri, OPEC's secretary-general, explained that the group had decided to open the taps at its summit in Vienna out of compassion for cash-strapped drivers around the world. “Our message to consumers is that we care,” he told the press corps. But consumers who recall the earlier part of this decade, when the price vacillated between $20 and $30, are presumably not overwhelmed by the cartel's compassion.

The difference between now and then is OPEC's discovery that booming places like China have a seemingly unquenchable demand for oil. Oil producers, including those in OPEC, struggled to keep up. Prices rose, but demand kept on increasing too. By last summer, OPEC was already pumping as much oil as it could, and markets were fearful that hurricanes in the Gulf of Mexico or a political storm in the Persian Gulf would lead to shortages. The oil price duly rose to over $77 a barrel.

When those fears dissipated, it became clear that there was enough oil to go around after all. But by then, OPEC had developed a taste for $70 oil. So it cut production to stop prices from falling too far. When the oil price reached a new record of $78 a barrel last month, it was thanks as much to OPEC's diminished output as to runaway demand. The cartel has now proved that it has enough discipline to prop up prices by restraining supply if need be, and also enough spare capacity to temper prices when they rise too high for its liking. In other words, OPEC is back in control of the oil price.

This contains a grain of good news. Had a Katrina-like hurricane or a conflict between America and Iran destroyed lots of rigs last year, there would have been no one capable of compensating for the lost production by pumping more. Now, at least, oil consumers can go cap in hand to the likes of Saudi Arabia, as Samuel Bodman, America's energy secretary, did before the OPEC meeting.

But for all Mr al-Badri's magnanimous talk and Mr Bodman's pleading, do not expect OPEC to grant the world's drivers much respite. Several of its members, including Algeria, Iran and Venezuela, argued

against higher quotas on the grounds that global financial jitters and an incipient economic slowdown in America might lead to lower demand for oil, just as OPEC was increasing supply. In the end, the cartel resolved to raise its output by only 500,000 barrels per day, or less than 2%, although the increase comes in addition to the 900,000 b/d its members are already pumping in excess of their quotas. The extra supply did not dent the price at all; in fact, the oil price hit new records following OPEC's announcement.

Ignorance of the law

That should worry OPEC's hawks more than it appears to. They seem to think that the world economy's ebullient growth over the past few years in the face of rapidly rising oil prices proves that it has developed immunity to oil shocks. The Chinese economy, for one, consumes more oil relative to its size than America's, but it is still galloping along. Americans, for that matter, show no inclination to buy less petrol even at prices over $3 a gallon.

Yet the laws of economics have not suddenly been repealed. Dearer oil will cut economic growth. Over the longer term, consumers respond to higher prices by driving more efficient cars and substituting other fuels for petrol. America's romance with gas-guzzling sports-utility vehicles appears to be fading and its affair with biofuels is ever more passionate. At the same time high prices are bound to constrain demand, and unpredictable economic growth and Middle Eastern politics make the future of both demand and supply uncertain. OPEC may appear to have regained control over the oil price, but it's not likely to last.

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On genetics and insurance, peace in the Middle East, Princess Diana, holidays, forest fires, Nicolas Sarkozy

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Covering the risks

SIR – Your briefing on the consequences for the insurance business from advances in genetic testing got it slightly wrong when talking about American health-insurance ("Do Not Ask or Do Not Answer?", August 25th). The American health-care financing system has already almost eliminated the medical underwriting that makes discrimination on the basis of health risks, including genetic risks, possible.

Some 30% of Americans receive their health cover through federal programmes, which do not discriminate on health risks. Half are covered through an employer, and federal law prohibits employers from using health risks, including genetic ones, when offering health coverage. Only around 5% buy individual, and medically underwritten, health insurance (15% have no coverage). The vast majority of those people, however, live in the more than 40 states that ban genetic discrimination in health insurance.

Nevertheless, it is important that the Genetic Information Non-discrimination Act be passed in order to set clear standards and assuage public fears because, as you argue, genetic discrimination and adverse selection raise serious problems for life, long-term care and disability insurance.

Hank Greely
Professor of law
Stanford University
Stanford, California

SIR – I treat dozens of injuries every day in the emergency room, ranging from mundane slips and falls to freak accidents, such as one incident when a knife was dropped from scaffolding several metres above an unfortunate woman's head and became lodged in her arm. You can rest assured that even the genetically favoured will want to continue buying health insurance so long as there is no genetic basis to bad luck.

Dr Carol Seyboth
Munich

Striving for peace

SIR – You seem to dismiss the efforts of peace groups working towards the co-existence of Israelis and Palestinians when you ask, "if so many people are intent on making peace, why hasn't it happened by now?" ("Still campaigning for co-existence", September 1st). All the Israeli, Palestinian, Egyptian, Jordanian and Saudi leaders we have spoken to have praised groups working at the grassroots. These leaders emphasise that in light of Hamas's threats to derail the discussions between Mahmoud Abbas and Ehud Olmert and the November summit, public opinion and the amplification of a moderate voice is imperative. For that reason, the OneVoice petition you referred to, which will rally a million Israelis and Palestinians, is historic and quite unprecedented. Mobilising so many people will aid our elected leaders in their efforts to summon the political and moral will to begin immediate, uninterrupted negotiations for a two-state solution.

Cynicism is a luxury for those who watch the conflict in the Middle East as a geopolitical sport. Despair, pessimism and inaction are tantamount to a proxy vote for militant absolutism. We have no option but to prevail.

Daniel Lubetzky
Founder
OneVoice Movement
New York

SIR – I have taken part in one of the Seeds of Peace camps you mentioned. They encourage young Arab and Israeli men and women to see their purported “enemies” as individuals, even friends. I witnessed vast changes in attitudes and perspectives from people on both sides of the conflict; the campers forge an understanding and solidify their relationships when they return to their homelands. Hopefully, Arab and Israeli leaders of the future will have attended these gatherings.

Eitan Paul
Princeton, New Jersey

Tear-jerkers

SIR – Whatever the underlying causes of “Diana week” there can be little doubt that the British media (especially television journalists) believe that viewers have an insatiable appetite for public displays of private grief (Bagehot, August 25th). Day after day, relatives of victims of violent crime are invited to speak of their “feelings”. If tears are not immediately forthcoming, the interviewer prods them with emotive questions until they are openly weeping before the lingering camera.

The popular mood is such that to grieve privately and bear one's sorrow in public with dignity risks censure for lack of human feeling and sensitivity, or to be “emotionally deformed”, as Bagehot puts it. It was not always so, but the British public's preference now seems to be for displays of maudlin sentiment, on television at least.

Walter Emerson
Auradou, France

A vacation paradise

SIR – Anyone in Britain dissatisfied with the number of public holidays they get ought to spend a few years in America (“An idle proposal”, September 1st). The nine public holidays we receive are considered generous. But America's public holidays are roughly the inverse of Britain's. For most American employees there are no holidays after New Year's Day until July 4th. Then we have quite a few holidays from July until the end of the year. So the strategy is obvious: work the first half of the year in Britain, the second half in America. Or better still, work the entire year in Belgium.

Bob Lockhart
Allen, Texas

Native American remedy

SIR – Contrary to your assertion, wildfires in today's mismanaged, overgrown forests are not a good thing (“Burn, baby, burn”, August 25th). In fact, anti-logging, anti-grazing policies are causing environmental as well as economic destruction in America's mountain West. We could learn a thing or two from the Mescalero Apaches in New Mexico.

The Apaches, who never went in for much environmental nonsense, log their reservation land and practise controlled burning, as they have for hundreds of years. This clears the underbrush but leaves the big trees unharmed. The result is a healthy, vibrant forest with a canopy that is open enough to allow sunlight to reach the forest floor, producing a solid turf of native grasses that support a large commercial cowherd as well as a high percentage of the region's wildlife.

Michael Cade
Balmorhea, Texas

SIR – You report that millions of acres have either been deliberately burned or left to burn to thin forests in the American West. It would be interesting to know just how much carbon dioxide was created as a result of the foresters' actions.

Thomas Cathey
Boulder, Colorado

Tour de Sarkozy

SIR – Nicolas Sarkozy may indeed be “immodest”, but you are certainly not helping to humble him (“The world according to Sarkozy”, September 1st). Besides your leader, articles about the French president lead your Europe, Business, and even your Books and arts sections in the September 1st issue. All with accompanying visual images. I wonder if this is a record.

Éloi Laurent
Paris

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Pakistan

Home and away

Sep 13th 2007 | LARKANA, MATTA AND RAWALPINDI
From The Economist print edition

Reuters

The rebuffing of Nawaz Sharif has only made Pakistan more unstable

Get article background

NAWAZ SHARIF, a former prime minister of Pakistan, landed in Rawalpindi on September 10th with his head bowed in prayer and his supporters erupting around him. He was back from a seven-year exile to challenge Pervez Musharraf, an army coupster who had toppled and imprisoned him. “Go, Musharraf! Go!” screamed his retinue as Mr Sharif's plane rumbled to a halt. But four hours later it was Mr Sharif who was on the move. In the airport's VIP arrivals lounge he was charged with corruption, arrested and deported to Saudi Arabia.

It was almost certainly what he had expected. During the flight, Mr Sharif made many bold promises: to wage a “final battle” against military dictatorship, bring “undiluted democracy” to Pakistan, and so forth. He is not the first Pakistani politician to have promised these things. Indeed, as a political drama, his homecoming was squarely within Pakistani tradition. It was chaotic. It was cacophonous. And its conclusion, as became gradually apparent, had been scripted by soldiers and spies, rulers of Pakistan for most of its history.

The play began last month when Pakistan's Supreme Court, in a new-found spirit of judicial independence, ruled that Mr Sharif had an “inalienable right” to return home. With presidential and parliamentary elections looming, he vowed to do so. As far as anyone could tell—for opinion polls are rare and often unreliable in Pakistan—his popularity surged. Many Pakistanis, battered by persistent inflation and authoritarian government, have had enough of General Musharraf.

Meanwhile, the fortunes of Mr Sharif's main rival, Benazir Bhutto, leader of the Pakistan People's Party (PPP) and another exiled prime minister, are declining. She has chosen not to confront General Musharraf but to try to share power with him. In recent months, his intelligence chiefs have been negotiating with her to make this happen. By associating with a military dictator, Ms Bhutto, whose party is Pakistan's most liberal and popular, was bound to lose credibility. Nonetheless, she has gambled that a deal would be worth it.

Reuters

Her terms are these: she wants a passage home unencumbered by corruption charges relating to her two terms in office. She wants General Musharraf to hand in his army papers and revoke a law that restricts prime ministers to two terms. She also wants the general to give up his current presidential power to sack the prime minister. In return, she is prepared to support his bid for presidential re-election. Whether the constitution allows

this is, at best, open to question. Ms Bhutto has therefore been leaching credibility, and still she has no deal.

Benazir, increasingly discredited

Undaunted, in Garhi Khuda Bakhsh, Ms Bhutto's ancestral seat in southern Sindh province, workers are rushing to finish a renovation of the 130-foot white Mughal-style mausoleum that bears testimony to the tragic fortunes, and scornful pride, of Pakistan's leading political dynasty. It holds the bones of Ms Bhutto's father, Zulfiqar Ali Bhutto, a former prime minister hanged by his successor, and also of her two brothers, Murtaza and Shah Nawaz. They, too, died violently: Shah Nawaz poisoned in a Bhutto pad in the south of France, Murtaza killed in a shoot-out in Karachi in 1996, during Ms Bhutto's last government. Supporters of Ms Bhutto, including America and Britain, rightly see her as a Western-educated (Harvard and Oxford) liberal intellectual. But this is not the only baggage she comes with.

By beating Ms Bhutto home, Mr Sharif had hoped to capitalise on his more obviously heroic stand. Indeed, this looked likely until September 8th, when Saudi Arabia's chief of intelligence, Muqrin bin Abdul Aziz, showed up in Islamabad and warned Mr Sharif to stay away. By so doing, said Mr Aziz, he would honour a promise he had made to the Saudi royals in 2000. In return for their help in springing Mr Sharif from jail, where he was serving a life sentence for treason and hijacking, he had vowed to quit Pakistan for a decade. The Supreme Court's ruling last month overrode this agreement; but no matter to Mr Aziz.

The flight back

It was a gloomy-looking Mr Sharif who turned up at London's Heathrow airport on September 9th to catch an overnight flight. A tearful scene ensued. At the departure gate, Mr Sharif ordered his brother and closest ally, Shahbaz Sharif, to stay put. “At the eleventh hour!” lamented Shahbaz, who last week was charged with multiple murders relating to his time as chief minister of Punjab.

On the plane was another surprise. No sooner had Mr Sharif boarded than a Pakistani journalist collapsed in the aisle. A doctor was called and diagnosed a heart attack. But Pakistani observers exchanged dark glances. The spies of General Musharraf's Inter-Service Intelligence agency (ISI), they suggested, are an ingenious lot.

AFP

Helpless against the terrorists

It was a surprise when the plane took off. Over the next eight hours, Mr Sharif received foreign journalists at his first class seat. Had they fancied wandering into the cockpit, they could have done. The usual in-flight rules were discarded. The aircrew seemed resigned to chaos. And the purser was for the PPP.

On the ground in Pakistan, every leader of Mr Sharif's Pakistan Muslim League (Nawaz) party (PML-N) was being arrested. Some 1,000-4,000 party activists were also allegedly rounded up. The roads around Islamabad airport were blocked with road-making machinery. The few PML-N supporters who breached this defence, after Mr Sharif's incoming plane was sighted, were bludgeoned with tear-gas cannisters and beaten by riot police.

Inside the airport, paramilitary police encircled the plane and a nervous immigration official boarded it. With trembling hands he clutched a crumpled brown paper bag containing an immigration stamp. His task

was to admit Mr Sharif to Pakistan—so honouring his “inalienable right”. Wise to the ruse, Mr Sharif and his retinue refused to hand over his passport. But shortly after disembarking he was charged with involvement in an alleged $20m money-laundering scam and led away, his passport apparently unstamped.

Pakistan, a place of 160m people and one of Asia's fastest-growing economies, should not be a banana republic. Yet, in its current crisis, that is increasingly how it appears. By ignoring the Supreme Court, General Musharraf has in effect declared a state of emergency. Were he now to offer Ms Bhutto a deal on her terms, almost incredible as this would be, she might feel compelled to decline. If the elections go ahead, the opposition parties may boycott them. They include the Muttahida Majlis-e-Amal (MMA), an alliance of Islamist parties previously allied with the general, as well as the PML-N and PPP.

And Pakistan faces another crisis, of security. It has a nationalist insurgency in its vast western province of Baluchistan, a Taliban insurgency in its rugged north-west and sporadic al-Qaeda-style suicide-blasts in every main city. Official figures count around 250 suicide bombers, including some who were foiled by security forces, in the past five years. The most recent, in North-West Frontier Province (NWFP) on September 11th, killed 18 people.

The tempo of the attacks increased in July, when the army stormed a radical mosque in the middle of Islamabad called Lal Masjid. Within a stroll of Pakistan's Supreme Court and Parliament building, over a hundred people were killed in the battle that ensued. The mosque's preachers, two brothers, one of whom was killed, had ties to militant groups including al-Qaeda. Yet the terrorism is also the inevitable outcome of the fact that much of north-western Pakistan, especially the semi-autonomous Pushtun tribal region, has been taken over by the Taliban.

General Musharraf's efforts to combat these fanatics, who include many of Afghanistan's former rulers, have been disastrous. Before the Lal Masjid battle, the army had around 80,000 troops in and around the tribal areas, along the border with Afghanistan. They were first dispatched there shortly after America invaded Afghanistan in 2001. In on-off campaigning, over 800 Pakistani soldiers had been killed by these militants. Since Lal Masjid, General Musharraf has dispatched another two divisions to the region, and another 250 soldiers have been killed.

A man on a white horse

In Swat, a fertile valley adjoining the tribal areas, a brigade of these reinforcements arrived last month. Their task is daunting. Swat is the area of Mullah Fazalullah, a cleric who delivers Taliban edicts through a megaphone while mounted on a white horse. Mr Fazalullah, whose father-in-law incited thousands of local youths to fight with the Taliban in Afghanistan, has called for suicide blasts to avenge the “martyrs” of Lal Masjid. He has not been disappointed. As they advanced into Swat, the brigade was greeted by two suicide-blasts and a road-side bomb; 16 soldiers were killed.

Of course, Mr Fazalullah has gone to ground. And the local administration will not help the army unearth him. Javed Ali Shah, its senior official, said: “There will be no military operation in Swat.” The army is reported to be deeply unhappy, and no wonder. Last week 270 soldiers, including a dozen officers, were

taken hostage by a much smaller force of Taliban militants in the tribal agency of South Waziristan. They were captured without a shot being fired. “They are demoralised, it's a serious concern,” says an army pundit, former General Talat Masood.

It would hardly be surprising if Osama bin Laden was in north-west Pakistan. American officials have often suggested this, though they seem unable to prove it. As for Pakistan, it prefers not to discuss the great sheikh's possible whereabouts. The MMA, General Musharraf's former ally, runs the government in NWFP. Like Mr bin Laden, many of its leaders won glory during the Afghan *jihad* of the 1980s, which was run from Pakistan.

Moreover, some senior army officers may share their sympathies. The then army spokesman, Major-General Shaukat Sultan, said last year that if Mr bin Laden was in Pakistan he was free to live a “peaceful life”, provided he kept out of trouble.

That may be quite a mild view in Pakistan. According to a poll released on September 11th, Mr bin Laden is more popular than General Musharraf. The poll found that 46% of Pakistanis approve of al-Qaeda's chief, against 38% for their president. In addition, 66% of respondents said that America was fighting a war on terror in order to attack Islam.

America's stake

Pakistan is bigoted and becoming more so. Yet the poll should be read cautiously. Radical opinions are casually expressed in Pakistan, by members of the English-speaking elite as well as the Urdu-speaking masses. But even with Machiavellian help from the intelligence agency, the MMA won only 11% of the vote in 2002. In the coming election, if they participate, they may do better. Nonetheless, except for the stringent Pushtuns, most Pakistanis are moderate.

Last week in Sehwan, a town in central Sindh, half a million Sufi pilgrims gave a demonstration of this fact. They are followers, like most Pakistanis, of the heterodox Barelvi school of Sunni Islam. And so they whirled, chanted prayers, blew kisses and smoked massive quantities of dope to celebrate the 755th anniversary of Lal Shahbaz Qalandar, a Sufi saint. “We are the anti-Taliban,” claimed Ahmed Bhutto (no relation), in a room thick with the scent of incense and rose petals. “We stand for love, tolerance and the great infinity.”

If only the mortal world of international relations were so far-sighted. But it is not. That is why, even as General Musharraf's popularity plummets, America is stoutly backing him. The general's campaign in north-western Pakistan may be disastrous, but America has no better idea of how to quell the mayhem there. Indeed the campaign is, more or less, according to an American design. General Musharraf invaded the tribal areas at America's urging. America is closely involved in prosecuting the campaign, especially at an intelligence level. After all, it is paying for it. In the past five years, America has swollen General Musharraf's coffers with an estimated $10 billion.

Even for a profligate superpower, that is a considerable stake, and America's recently expressed dissatisfaction with General Musharraf should be measured against it. In short, America wants both democracy for Pakistan and General Musharraf. This is why it is urging the general to co-operate with Ms Bhutto. But if a democratic general turns out to be as self-contradictory as most Pakistanis think (and they should know), America would prefer to keep the general. Mr Sharif's summary ejection probably reflects this. It is hard to imagine that Saudi Arabia would have so grossly intruded into Pakistani affairs without America's approval, at least.

However will it end? In the long run, if history is a guide, the institutional damage that General Musharraf is wreaking will make Pakistan even more unstable. Never forget, for Pakistanis do not, that he is the country's fourth American-backed military ruler. At best, his rule will have delayed the onset of a serious effort to build the sustainable democracy that most Pakistanis crave. At worst, it will have made that task unachievable.

One indication of this, the most alarming aspect of the current political crisis, is that no Pakistani leader seems to be genuinely popular. Even if General Musharraf had not locked up the PML-N's leaders, it is doubtful they could have produced much of a multitude to greet Mr Sharif. Ms Bhutto, who said she would announce the date of her return on September 14th, might fare better. But she would be most unlikely to draw the adoring hundreds of thousands who welcomed her after her last return from exile, in 1986.

For Pakistan's other crisis, Islamist-stoked insecurity, there will be no ready solution. Pakistani Pushtuns may stay on the warpath as long as foreign troops remain in Afghanistan. They always have before. And if Islamist militancy is to be a fixture in Pakistan, America should worry about where Pakistani allegiances may be heading.

General Musharraf will not worry about this. He wants to cling to power, and he has two options. First, he can seal a deal with Ms Bhutto. So long as there is no popular backlash against Mr Sharif's ejection, especially by the country's lawyers, who provoked mass protests against General Musharraf earlier this year, she may agree to this—provided the general sheds his uniform by early next year at the latest.

He is reluctant to do so. There is a notion, dear to America, that General Musharraf could be a strong civilian president, overseeing the prime minister and the army. But there is no history to support this belief. The army, and it alone, is General Musharraf's constituency and the source of his power. By stripping himself of its uniform he reasonably fears that he would be an emperor without clothes.

His alternative is to go it alone. He already has a simple majority in Parliament, which is sufficient for a presidential re-election. Without the PPP, he will not have the two-thirds majority necessary to make constitutional changes. In effect, that means that if his re-election were challenged on legal grounds—as it surely would be—General Musharraf would be at the mercy of the Supreme Court.

On recent form, the judges might rule against him. If so, General Musharraf would probably then declare martial law. This would allow him to re-run the events that followed his 1999 coup: he would gut the Supreme Court of dissidents, ask the remaining sycophants to rule on the legality of his suspension of democracy, then hold elections. So long as a fair portion of the opposition participated in these, they would probably pass muster with America. But how would Pakistanis respond?

The name of Lal Shahbaz Qalandar, that Sufi saint, is linked in Pakistan with both unshakeable tolerance and unrestrainable agitation. A famous Urdu poem, “The complete intoxication of Qalandar”, explores this duality. But in real life, alas, there can be no such co-existence.

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America and Iraq

The general speaks

Sep 13th 2007 | WASHINGTON, DC
From The Economist print edition

Getty Images

David Petraeus says that Iraq is improving and some 30,000 American troops can come home by next summer. Congress wants more

Get article background

ONE pundit likened David Petraeus's reception on Capitol Hill this week to a Roman triumph. Certainly, America's top general in Iraq was decked with metaphorical laurels. Even the most anti-war members of Congress were careful to emphasise how much they admired his selfless service. But there the similarity ended. A Roman triumph marked the victorious end of a campaign. In Iraq, neither victory nor end is in sight. General Petraeus was not in Washington to wave at jubilant crowds, but to offer a guardedly optimistic progress report, to endure hours of repetitious questioning by lawmakers, and to hear protesters in pink yell anti-war slogans before being hustled from the room.

Along with America's ambassador to Iraq, Ryan Crocker, the general acquitted himself pretty well. The two career public servants seemed more plausible to more Americans than the president whose policies they implement. When MoveOn.org, an anti-war group, took out an ad in the *New York Times* suggesting that General Petraeus is a traitor (General Betray-us), the idiocy of the charge embarrassed the Democrats, the party MoveOn supports.

General Petraeus insisted that his testimony was his own, and had been neither seen nor cleared by the White House. Of the surge (this year's escalation of troop numbers in Iraq), he said that its military objectives are, in large measure, being met. The number of Iraqi civilians dying violently each month has fallen by 45% since December, when sectarian killing reached a peak. It has fallen by 70% in Baghdad, where most of the extra troops are concentrated. (However, measured from March, when the surge properly got under way, the reductions are marginal.)

As expected, the general highlighted the fact that Sunni Arab tribes in Anbar province, who used to shoot at Americans, have now turned on the al-Qaeda warriors in their midst and sought American help in killing or expelling them. Al-Qaeda overplayed its hand, said Mr Crocker, by beheading children and cutting off fingers as a punishment for smoking.

This is not the same as victory. Al-Qaeda in Iraq is not defeated, said General Petraeus, but it is off balance, and what some call the “Sunni awakening” has begun to spread. Car bombings and suicide attacks, an al-Qaeda speciality, are down from 175 in March to 90 last month. American and Iraqi troops have reduced the area in which al-Qaeda enjoyed sanctuary, shut down five al-Qaeda media cells, captured the group's Iraqi leader and killed or captured nearly 100 of its other commanders and 2,500 rank-and-file fighters.

The general also claimed some successes against Shia militias. He cited the capture of a number of senior leaders, as well as the deputy commander of Lebanese Hizbullah Department 2800. This he said,

is an Iranian-backed group that, with the Iranian al-Quds Force, is arming, training and sometimes directing Shia militias to undermine the Iraqi state.

Leaving aside al-Qaeda's apocalyptic goals and Iran's more pragmatic ones, the fundamental source of the conflict in Iraq is competition among ethnic and sectarian communities for power and resources, according to the general. This competition, he reckoned, is inevitable; America's goal should be to ensure that it is resolved with as little bloodshed as possible.

As reasons for optimism, he noted that sectarian killings were down by 55% since December. Mr Crocker added that Muqtada al-Sadr, perhaps the most powerful anti-American Iraqi Shia leader, has now told his men to stop attacking Iraqis or Americans, prompted perhaps by widespread revulsion at attacks by his militia, the Mahdi Army, on fellow-Shia worshippers in the holy city of Karbala.

The most striking parts of the general's testimony were his recommendations for what to do next. He said that since security is improving and the Iraqi army is growing more capable, America should be able to withdraw a marine unit immediately, a brigade by Christmas and some 30,000 troops by next summer. That would bring the number of American troops in Iraq back down to about 130,000—the same as before the surge. Further reductions would depend on conditions on the ground. President George Bush was expected to endorse those recommendations later this week. But this could well mean that the pre-surge level of troops will be maintained until the end of Mr Bush's presidency—a far cry from the rapid withdrawal Mr Bush's opponents have called for.

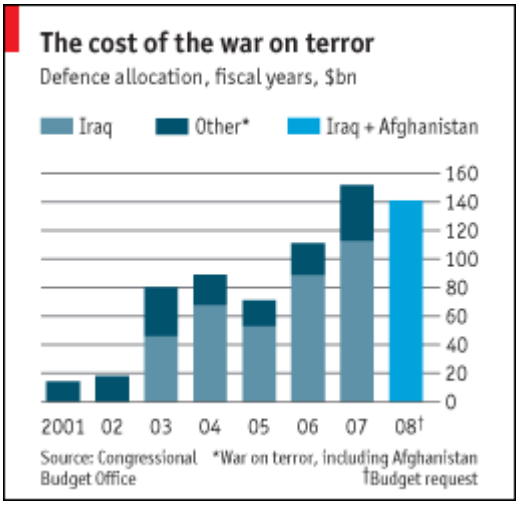
The counter-assault

Democrats in Congress attacked the general's and the ambassador's evidence in two ways. First, they queried their guarded optimism. Although most reports agree that violence in Iraq has subsided this year, at least one recent one concluded that the data were too muddy for certainty. And even if the killing has slowed, there is still far too much of it and no guarantee that it will not resume once the surge ends. Even if one accepts that sectarian violence has ebbed, isn't this because so many mixed districts have already been purged of minority groups? “Take off your rosy glasses,” chided Barbara Boxer, a Democratic senator from California.

Second, Democrats pointed out that the declared purpose of the surge was to buy time for Iraqi politicians to bring about national reconciliation. But those politicians have failed to disband militias or pass laws laying out how power and oil revenues will be shared among Kurds, Shia and Sunni Arabs. Ike Skelton, the Democratic head of the House Armed Services Committee, put it in folksy terms: “To this country lawyer, [it appears that] parliamentarians in Iraq have been sitting on their thumbs, while the young men and women of America are doing their best to bring security.”

Mr Crocker urged patience. The national government has not passed those crucial laws, but it acts in some ways as if it had, he argued. Oil revenues are being fairly shared between the provinces, and former rebels and Baathists have been welcomed into the security forces. Nation-building takes time, the ambassador said, especially in a traumatised society where any potentially unifying leader of, say, Nelson Mandela's stature would have been murdered by Saddam Hussein. But Democrats are not in a patient mood, and several of them are running for president.

Senator Barack Obama used his time allotted for questioning the two witnesses to make a speech. If the American people had understood, when Mr Bush announced his plan to invade Iraq, that they would end up spending $1 trillion and losing thousands of American lives to create a new al-Qaeda base in Iraq, to boost terrorist recruiting, to strengthen Iran and to make life worse for Iraqis, “I think most people would have said that's a bad deal”. He concluded that “we have now set the bar so low that modest improvement in what was a completely chaotic situation...is considered success. And it's not.” (The next day, Mr Obama said he wanted all American troops out of Iraq by the end of 2008, and proposed a UN-sponsored constitutional convention which would not end until Iraqi politicians had settled their worst differences.)



Hillary Clinton, who is distrusted by many Democratic primary

voters because, unlike Mr Obama, she initially supported the war, was even harsher on General Petraeus and Mr Crocker. She told them they were the de facto spokesmen for a “failed policy”, and that their testimony required the willing suspension of disbelief. She noted that she had spent the morning (it was September 11th) at Ground Zero in New York, where the names of those who died in the twin towers were read out in the rain, before bewailing Mr Bush's response to that attack.

Osama bin Laden is still on our screens taunting us, she said, and the Taliban are resurgent in Afghanistan. Evidence that Iraqis are reconciling from the bottom up, she argued, is merely anecdotal.

Hard pounding for the Democrats

Such criticism resonates with a majority of Americans, but the Democrats may still find it hard to make political capital from it. General Petraeus is widely seen as a straight-shooter, and his testimony did nothing to mar that reputation. Asked by John Warner, a sceptical Republican, if his recommendations would make America safer, he replied: “Sir, I don't know.” If such a well-informed and non-partisan source says that a rapid pull-out would invite calamity, Mr Bush can argue that it would be rash not to follow his advice.

The Democrats also have another, deeper problem. They won both houses of Congress last year by promising to end the war in Iraq. Despite strong public support, they have not even come close to doing so. Mr bin Laden, who has apparently been reading Noam Chomsky in his cave, says this is because America is ruled by large corporations. Others prefer a less sinister explanation. The Democrats' majority is not large enough to overcome a Republican filibuster in the Senate let alone a presidential veto. And this week's hearings have made it unlikely that more than a handful of Republicans will switch sides to vote with them just yet. Earlier this year, the Democrats failed to attach a timetable for withdrawal to the president's demand for more money because they lacked the support of defectors. If they try the same trick again with this year's defence budget, which must be passed by the end of this month, they will doubtless fail again.

Mr Crocker was keen to stress the moral reasons for staying on. Iraq came close to unravelling in 2006, he said, but he now thinks it is fitfully on the mend. If America abandons or drastically curtails its efforts there, however, he thinks the country will fall back into chaos—involving appalling human suffering and turning the country into a haven for al-Qaeda. Senator John McCain, a Republican presidential candidate who advocated a surge long before it happened, was even more compelling. He reckoned that an American withdrawal would convince jihadists that they “have toppled a major power on earth and that all else is possible.”

Harry Reid, the Senate majority leader, disagrees. On September 12th he said that Democrats will introduce budget amendments next week to change the course of the war in Iraq. Exactly how, he would not say. But he promised to demand a bigger withdrawal than General Petraeus recommends. Mr Reid said he hoped Republicans would support him. But it seems a forlorn hope.

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Presidential politics

The celebrity primary

Sep 13th 2007 | LOS ANGELES
From The Economist print edition

The contenders battle among the stars

FORGET Iowa and New Hampshire—at least for a moment. This week the two leading Democratic candidates for the presidency were competing for Tinseltown's affections and cheques. Oprah Winfrey, the queen of daytime television, invited a handful of film stars and 1,000 or so others to a “celebration” for Barack Obama. The fact that she tapped them for $2,300 each (the maximum allowed under campaign-finance rules) apparently did not make the occasion any less cheerful. Not to be outdone, Hillary Clinton planned to attend a glitzy fund-raising dinner hosted by Magic Johnson, a basketball star and entrepreneur.

There may be five months to go before California's primary, but the battle for Hollywood is well under way. Only two candidates matter in this Democratic stronghold. Mr Obama took an early lead, winning the backing of George Clooney and Matt Damon. He is also supported by David Geffen, once a big noise in the film and music business and still a stupendously rich man. Mrs Clinton has picked up support from establishment figures such as Peter Chernin of News Corporation and Haim Saban, a television investor. She is also the favourite of Jenna Jameson, star of such films as “Blown Away”.

Politicians have wooed Hollywood since the silent-film era, when stars like Charlie Chaplin and Douglas Fairbanks were persuaded to tour the country selling war bonds. But Tinseltown's politics has changed radically over the years. Under the old studio system executives decided with whom stars would be photographed, says Steve Ross of the University of Southern California, who is writing a book on the subject. That meant Hollywood projected a staunchly Republican image.

These days power lies with the talent, and they know it. “I've taken the time to familiarise myself with the impressive field of Democratic candidates”, Steven Spielberg announced in June, sounding less like a film director than a Chicago union boss, “and am convinced that Hillary Clinton is the most qualified candidate to lead us from her first day in the White House.” Ms Winfrey suggested, no more modestly, that her support for Mr Obama was worth more than her considerable fortune.

Since 1990 the film industry has given seven times more to Democrats than to Republicans, according to the Centre for Responsive Politics (in television the ratio is eight-to-one; in music four-to-one). Liberal views are not just tolerated but expected, and many Hollywood luminaries retain political advisers. Occasionally they veer too far to the left: Sean Penn, an actor, has been ridiculed for cosying up to Hugo Chávez, Venezuela's president.

But Mr Penn's political views will not cost him any film parts reckons Donna Bojarsky, an adviser to the actor Richard Dreyfuss and others.

Yet stars are most influential when they play against type. It is not a coincidence that two Republicans, Ronald Reagan and Arnold Schwarzenegger, have made the most successful leaps from screen to politics. Nor is it surprising that another Republican should attempt the same feat. Fred Thompson is tall and conservative, but the fact that he is currently running second in the Republican primary probably has more to do with his performances in “Law & Order”, a television series, than with his stint as a senator from Tennessee.

All of which suggests that Mr Obama, who is running to the left of Mrs Clinton, has less to gain from fawning celebrities—and potentially more to lose. Stardust is good, but too much can make a liberal politician seem other-worldly. That would not play well at the box office.

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Broadband internet

Wiring rural America

Sep 13th 2007 | BOWLING GREEN, KENTUCKY
From The Economist print edition

A public-private partnership success

FROM her remote farm in southern Kentucky, Lajuana Wilcher checks an online database for local ranchers demanding alfalfa. She can specify at what price she is willing to sell, which counties to search and whether her hay is square-baled or rolled. Without her high-speed internet connection, Ms Wilcher insists, it would take far too long to find the most generous alfalfa prices, order spare tractor parts and locate the best breeding stock for her small cattle operation.

Largely rural, Kentucky is best known for its bourbon and horse racing; it rarely ranks in the top tier of states on any measure of 21st-century success. According to Brian Mefford, president of ConnectKentucky, a public-private partnership, a few years ago the state had among the lowest rates of broadband availability in the country. Internet service providers could not be sure that there were enough Lajuana Wilchers in the Kentucky countryside to justify new investment in cabling or wireless transmitters.

But by the end of this year, Mr Mefford boasts, 98% of residents will have access to inexpensive broadband services. This is primarily because of ConnectKentucky's effort to map broadband demand in communities that didn't have access, he says, which indicated that enough people in Kentucky farm country would sign up if providers entered the market. At the same time, the organisation also talked up high-speed internet services to sceptical residents, creating demand where it was slack. Once isolated Kentuckians can now consult with doctors in faraway cities or telecommute.

ConnectKentucky is just one effort among many programmes in different states and within the federal government to wire up the American countryside. Backers compare them to Franklin Roosevelt's New Deal push to bring electricity to the hinterland. Supporters also hope expanded rural broadband access will stop the steady loss of population to cities and suburbs. But not all have been as successful as Kentucky's.

In 2004 President George Bush set a goal to provide every American with access to broadband by this year. The federal Agriculture Department has distributed over a billion dollars in grants and cut-rate loans to high-speed internet providers interested in rural markets. But by Mr Bush's yardstick, the effort has been a failure. Swathes of the country still lack broadband access, though it is hard to tell how far they extend. Admittedly, wiring up the West, with its greater distances and thinner population densities, is tougher than wiring up Kentucky.

Part of the problem has been the poor design of federal loan and grant schemes by Congress. A loose definition of “rural area”, for example, let an internet provider get federal funding to wire up a Houston suburb where million-dollar homes were under construction. Lawmakers in Washington, DC hope to reform the process. But there are other serious deficiencies in the federal system. Ensconcing large broadband loan and grant programmes in the Agriculture Department threatens to drain federal money for decades into parts of the country that already get other hefty—and often similarly mismanaged—federal farm and development subsidies. The comparison to Roosevelt's rural electrification efforts is apt: 70 years on, the Agriculture Department is still financing rural power companies long after electricity came to the American countryside.

Meanwhile, ConnectKentucky might beat Mr Bush to fulfilling his own goal. The group is morphing into a company called Connected Nation, and is helping to wire up the neighbouring states of West Virginia and Tennessee.

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The border

Free trade and fireballs

Sep 13th 2007 | AUSTIN
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Coming to America in an 18-wheeler

AP

Not fans of NAFTA

ON SATURDAY September 8th, at 1am, a lorry from Mexico crossed into Texas at Laredo. It trundled through the darkness to just outside San Antonio, where the driver, Luis González, stopped for a rest. He slept, ate a sandwich, and checked his tyres. He left that afternoon for North Carolina with ten tons of steel.

It was a historic journey. Since 1982, Mexican lorries entering America have been confined to a buffer zone along the border, where they must transfer their cargo to American lorries. The 1994 North American Free-Trade Agreement said that Mexican lorries should have access to American roads, and vice versa. But that plan met resistance. Watchdog groups argued that Mexican lorries have lower safety and environmental standards than their American counterparts. American drivers worried about their jobs.

In February, despite protests, the Department of Transportation announced a one-year pilot programme that would allow up to 100 Mexican carriers access to America. (The initiative also allows 100 American carriers into Mexico.) The department's timing was unfortunate: America has been in protectionist mood this year. The International Brotherhood of Teamsters as well as two environmental groups and a citizens' watchdog sued to block it. A federal appeals court ruled against them earlier this month. Democratic presidential candidates John Edwards and Barack Obama issued statements opposing the programme. Hillary Clinton said she found the scheme deeply troubling. Farther from the mainstream, people worried that the lorries would be full of drugs and illegal immigrants, and that having Mexican lorries roaming freely through America would be another blow to national sovereignty.

The Bush administration said these concerns had been addressed. Under the rules of the programme, Mexican lorries are subject to inspection at the border—“every truck, every time”. Their drivers must abide by American trucking rules while in the country and demonstrate a basic grasp of English. Mexican carriers may not carry cargo between American cities, and will therefore not be competing directly with local carriers.

John Cornyn, a Republican senator from Texas who favours the programme, struck a more emotional note. He assured doubters that he would never allow an unsafe truck on his state's roads. He failed to convince: the Senate this week voted to cut off funding, following a similar House vote in July. But George Bush has said he will veto the spending bill Congress sends him. The fate of the initiative is uncertain.

Fate has not favoured the free-traders. On September 9th, the day after Mr González began his trip, a

Mexican lorry crashed. It was travelling within Mexico, en route from an explosives plant to a mine, with a cargo of 25 tons of ammonium nitrate. The wreckage exploded in a giant fireball, killing more than 30 people. Mexican lorries are not allowed to carry hazardous material into America, but the tragedy hardly inspires confidence.

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Environmentalism and building

Green as houses

Sep 13th 2007 | PHOENIX AND SCOTTSDALE
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Building green is getting cheaper and more popular

DAVID HOVEY junior runs his hands over the steel beams of his home, and smiles. Tucked on a hillside in Scottsdale, Arizona that overlooks Phoenix, the property is stunning. It is made entirely of glass and recycled steel. The floor is elevated, leaving intact a 150-year-old ironwood tree. Overhangs keep out the sun. The building is environmentally friendly, but also marketable. Mr Hovey, who runs an architectural company called Optima, thinks many people will want a house just like this.

America is now enamoured of all things green. A study by the National Association of Home Builders (NAHB) found that some 90% of home-builders are now using green ideas. In 2005 the study found a 20% increase in the number of new homes that were environmentally responsible: water-efficient, energy-efficient, built of nature-friendly materials. Last year, the figures were up another 30%.

Green building has become big business. Banks such as Bank of America are adding more green financing packages. Shops selling green building supplies are springing up, as are giant shows. The world's largest exhibition for residential builders is West Coast Green, held in San Francisco. Last September almost 9,000 attended; 4,000 more are anticipated this year. In its honour San Francisco has proclaimed next week “West Coast Green Week”. Christi Graham, the president of West Coast Green, says lower building costs are helping the movement. It used to cost at least 15% more to build using eco-friendly ideas and products, but today they add only 1-3% to the cost of construction, she says.

Media attention helps, too. Al Gore's documentary on global warming, “An Inconvenient Truth”, helped get Hollywood on board. Last summer Brad Pitt teamed up with Global Green, a non-profit group, in a contest to design environmentally friendly homes for New Orleans. In April Robert Redford's series on ecology and green living was aired. *Vanity Fair*, *Newsweek*, *Forbes* and *Fortune* magazines have run green issues and *Entertainment Weekly*, a Hollywood monthly, featured Al Gore on its cover.

All this has helped Americans see that green building is easy, rewarding and responsible. The lesson is being learned in Scottsdale, a place whose extraordinary growth in recent decades has often meant swimming pools and green lawns somehow engineered in the desert. At Camelview Village, a multi-family development designed by Mr Hovey's father, who is also an architect, a “desert garden” covers the roof of each house. It is made of plants that require minimal watering, keep the roof cooler than black roof tiles and absorb lots of carbon dioxide. With 16 months to go until the complex is finished, 586 of the 709 units have been sold already. At Sterling Ridge, the Scottsdale property, solar panels and energy efficient glass will keep windows cool in the searing Arizona summers. The power savings are phenomenal, Mr Hovey junior says.

Suppliers of building materials and furniture are now scrambling to give green consumers what they want. There is heavy demand for things such as oriented strand board, which wastes less wood and uses trees such as aspen and poplar that grow fast. Bonded Logic in Chandler, Arizona, sells insulation made from shredded denim, a good mould-resistant alternative to fibreglass. Rastra, a company based in Scottsdale that makes concrete from recycled styrofoam, increased its sales by 385% between 2002 and 2005 and is looking for more American factories.

Lack of uniform standards is a problem. One company selling hydrochloric acid for etching cement floors reckoned that, because it was in gel form and could legally be washed down the drain, the product was environmentally friendly. And paint manufacturers are creating their own green labels instead of complying with regulations.

The US Green Building Council, for its part, is helping by expanding its energy-efficiency rating system from commercial properties to homes. This is the first voluntary national green-building standard; already, 7,500 homes and 330 builders are taking part in the pilot scheme. Home- and building-owners

receive credits for green materials used, which can then earn them lower mortgage rates from banks and tax incentives from state and local governments. The NAHB has also launched and trademarked its own national green-building standard.

Fans like Mr Hovey junior need no encouragement. As the sun dips over the Phoenix hills he surveys his masterpiece once more. “Green building”, he says, “is just the way to build.”

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Solar power

Trapping sunlight

Sep 13th 2007 | BOULDER, COLORADO
From The Economist print edition

Old ways can be the best ways

AP

The solar system

DESPITE its oppressive glow in much of the West, the sun has remained largely untapped as a source of electricity. The world's biggest solar farm, where more than 400,000 mirrors cover four square miles (10.3 square kilometres) of California's Mojave desert, was built in the 1980s and still churns out 354 megawatts of electricity, enough for 90,000 homes. But until recently no more large solar plants have been built, despite soaring demand.

Thanks to a confluence of factors—a federal tax credit, an uptick in federal funding for renewable energy R&D, the enactment of renewable electricity standards in many states and public antipathy toward greenhouse gas-belching coal-fired power plants—the sun is making a comeback. Concentrating solar power (CSP) is suddenly looking interesting again.

CSP systems capture and focus the sun's rays, using mirrors, to heat a working fluid to high temperatures and use it to drive a turbine. By contrast, photovoltaic solar power systems, mostly used on home rooftops, let light interact directly with semiconductor materials to generate power. As a source of large-scale power CSP is less expensive and more practical, not least because the technology can deliver power for hours after the sun sets using thermal storage. America's south-western deserts are an abundant source of sunshine that could meet the country's power needs several times over without releasing a molecule of carbon dioxide.

The first large CSP plant to be built since the 1980s went online in June in Nevada: it will generate 64 megawatts. Power companies have already signed long-term agreements with developers such as Stirling Energy Systems of Phoenix to buy up to 2,300 megawatts of CSP electricity from them. That is paltry compared with the nation's total electricity capacity of over 1m megawatts: but the Energy Department says at least 7,000 megawatts from CSP plants will be available by 2020. Meanwhile, large international CSP companies, such as Acciona Energy and Abengoa of Spain, and Solel of Israel, are busily setting up shop in America.

Electricity from the new plant in Nevada costs an estimated 17 cents per kilowatt hour (kWh), but projections suggest that CSP power could fall to below ten cents per kWh as the technology improves. Coal power costs just 2-3 cents per kWh. But that will rise if (as seems likely) regulation eventually factors in the environmental costs of the carbon coal produces. And CSP purveyors have a powerful friend: Harry Reid of Nevada, the Democratic leader in the Senate. Mr Reid recently declared that he will fight to prevent any new coal-fired plants in his state—or even nationwide.

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Lexington

Presumed guilty

Sep 13th 2007
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Illustration by David Simonds

A superb new book shows how trumped-up charges exposed faults in some of America's grandest institutions

ON THE night of March 13th 2006, 47 lacrosse players at Duke University, North Carolina, paid a couple of strippers to entertain them. Things went badly from the start. The girls arrived late. One of them, Crystal Mangum, was so drunk that she could not utter a coherent sentence. Her “dance” lasted four minutes. But over the next few days a sordid evening mutated into a life-ruining tragedy. Ms Mangum alleged that some of the players had beaten and gang-raped her. And the full force of the American legal system and media machine was deployed against a group of young men who were presumed to embody all the evils of America's demons of racism and sexism. The students Ms Mangum accused are white: Ms Mangum is black.

The accusation was a transparent lie from the start. Ms Mangum, who had been picked up by the police, brought up the subject of rape only when she was confronted with the possibility of a spell in a mental hospital. She recanted her accusation and then recanted her recantation. She told conflicting stories that numbered her assailants at anything from two to 20. Her co-dancer described her claims as “a crock”. The police who interviewed her on the first night regarded her charges as incredible—and, in truth, she had a long record of alcohol and drug abuse, mental instability and making up far-fetched stories.

Yet, a few weeks later, three of the students were arrested and charged with rape amid the usual media frenzy. Why did such a tissue of lies produce a high-profile prosecution? And why did the media and many of Duke's faculty side with the stripper, not the lacrosse players? This is the subject of “Until Proven Innocent”, a superb new book by Stuart Taylor and K.C. Johnson: a book that not only reads like a legal thriller (John Grisham provides one of the blurbs), but also exposes deep problems with America's legal system and academic culture.

The architect of the disaster was Mike Nifong, the district attorney for Durham County, North Carolina. Mr Nifong faced a close election campaign, and he relentlessly went after the young men. He ignored a mass of contradictory evidence when he took up the case. He spent hours talking to the press and smearing his victims. When DNA evidence failed to support Ms Mangum's story, he first refused to hand it over to the defence and then ignored it. Mr Nifong was ably assisted by the national media and Duke faculty. The print media churned out headlines about “a night of racial slurs, growing fear and finally sexual violence”, and the TV talking heads revelled in the story line. This column, to its shame, echoed the prevailing wisdom.

Radical students stomped around the campus banging pots and demanding justice (one sign

recommended castration). And a crowd of radical professors pronounced the students guilty as sin. Some professors used the “rape” to illustrate lectures on racial and sexual repression. Several gave invective-laden interviews to the press. On April 6th 2006, 88 faculty members took out a full-page advertisement in the college newspaper condemning the lacrosse players. In April 2007, all charges were dropped.

The case provides a vivid example of the way in which a rogue prosecutor can warp the legal system. “The prosecutor has more control over life, liberty and reputation than any other person in America,” wrote Robert Jackson, one of America's great attorneys-general, in 1940. “While the prosecutor at his best is one of the most beneficent forces in our society, when he acts from malice or other base motives, he is one of the worst.”

There are more of them out there

Mr Nifong was clearly one of the worst. But he is not alone: American prosecutors increasingly mimic the win-at-any-cost ethic of defence lawyers. A study by the Centre for Public Integrity in 2003 found that numerous prosecutors had stretched, bent or broken the rules. The case also provides a vivid example of the evils of political correctness, which is rampant in the media. One writer noted that “You couldn't invent a story so precisely tuned to the outrage frequency of the modern, metropolitan, *bien pensant* journalist.”

A striking number of professors were willing to trample all over legal process in their rush to declare the lacrosse players guilty before charge, let along trial. And they did so solely on the basis of the players' race and gender. One professor, Houston Baker, denounced the lacrosse players as “young white, violent, drunken men veritably given licence to rape, maraud, deploy hate speech”. Duke's politically-correct faculty thus produced a mirror image of the worst racism of the South in the 1950s, when people were pronounced guilty—and denied their legal rights—solely because they were black. While all this was going on Duke's president, Richard Brodhead, did little, if anything, to defend the lacrosse players or to criticise the faculty for its lynch-mob mentality. A university that charges students over $40,000 per year essentially abandoned three of them to the bullying of an out-of-control prosecutor.

Some people have at least learned from the disaster at Duke. Mr Nifong has been sacked and stripped of his law licence. Last week he was sent to jail, though only for a day, for his numerous misdemeanours. The press has struggled to put the record straight—and several people have written their own mea culpas.

The only people who, it seems, have learned nothing from all this are Mr Nifong's enablers in the Duke faculty. Even after it was clear that the athletes were innocent, 87 faculty members published a letter categorically rejecting calls to recant their condemnation. And one professor, proving that some academics are as far beyond parody as they are beneath contempt, offered a course called “Hooking up at Duke” that purported to illustrate what the lacrosse scandals tell us about “power, difference and raced, classed, gendered and sexed normativity in the US.”

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Felipe Calderón

Mexico's teetering president

Sep 13th 2007 | MEXICO CITY
From The Economist print edition

Illustration by Claudio Munoz

Bombed pipelines and battles in Congress, but the reforms go on

Get article background

THIS week did not start well for Felipe Calderón, Mexico's president. After months of negotiations, his government looked set to push through fiscal reforms designed to boost tax revenue by 2.5-3% of GDP and thereby keep the country solvent. They were supposed to be ready by September 8th, the day the government had to send the 2008 budget to Congress. But because of a last-minute hitch, they failed to get through in time.

Then came the bombs. On September 10th six explosions ripped through gas pipelines in the state of Veracruz, disrupting oil and natural-gas supplies, shutting down factories and forcing thousands from their homes. It was the third such attack in the past three months, and the most severe. Left-wing rebels claimed responsibility. Pemex, the state oil company, says it hopes to restore a full service within the next few days.

But all may not be lost for Mr Calderón's tax plans. The government has sent Congress two budgets, one conditional on the reforms, the other based on the assumption that they will not get through. Congressional leaders from both Mr Calderón's centre-right National Action Party (PAN) and the Institutional Revolutionary Party (PRI), which holds the balance of power in Congress, are now confident that the package will be passed within the next few days. It has already been approved by a committee in the lower house after only minor changes.

At its heart is a new tax on corporate net income, starting at 16.5% and rising to 17.5% after three years. Salaries and employee benefits will be deductible, as will long-term investment spending. The opposition Party of the Democratic Revolution (PRD) would prefer a bigger 28% corporate tax. It also opposes a planned 5.5 percentage-point rise in petrol taxes, to be distributed to state and local governments. But otherwise its own tax reform plans are not so different from the government's. It is therefore thought unlikely to mount an all-out attack on Mr Calderón's package.

If the debate had remained focused on tax, the fiscal reform bill probably would have been passed by the September 8th deadline. But it got entangled in a bid to reform Mexico's electoral system. Under an all-party bill, which passed the Senate by a consensus vote early on September 13th (but still has to get through the lower house), the length of federal election campaigns would be reduced; the Federal Electoral Institute (IFE), the independent electoral watchdog, would be given the power to regulate

primaries, as well as actual elections; the budgets of the political parties, all publicly funded, would be slashed; and campaign advertisements on television and radio, on which nearly $180m was spent in last year's elections, would be negotiated directly by IFE, using already-available official time-slots.

However, the electoral reform bill was held up by a PRD demand that Luis Carlos Ugalde, IFE's head, be forced out, along with the rest of the institute's executive council. Mr Ugalde's supporters say that getting rid of him in the middle of his seven-year term, due to end in 2010, would undermine IFE's independence. The PRD's demand may nevertheless be met. His critics say Mr Ugalde can no longer act as an effective arbiter; he lost the confidence of much of Mexico's political elite after his bungled handling of last year's contested presidential election. Some believe Mr Calderón has already agreed to serve up Mr Ugalde's head in order to get the fiscal reform through.

That package includes a change in the way Pemex's budget is fixed. The state oil company's revenues have been supplying the federal government with a massive 40% of its spending, leaving it with little to devote to exploration and refining. Mexico already imports 40% of its refined oil products, despite being the world's sixth-biggest producer of crude, and its oil reserves are expected to fall precipitously over the next decade. A complete restructuring of the country's energy sector is likely to take several years. But the planned fiscal reforms could at least give Pemex more autonomy over its share of the public coffers.

Compared with Pemex's structural problems, the spate of pipeline bombings has been no more than a passing headache. The fiscal reforms take a first step towards addressing these problems, as well as helping avoid a projected deficit in coming years. The electoral package is also just a first step. Both now look likely to be approved. Although Mr Calderón has not managed to get these bills through Congress as swiftly as his state-pension reform this spring, he has maintained his reputation as an able negotiator.

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Canada

A haven for villains

Sep 13th 2007 | VANCOUVER
From The Economist print edition

The political reasons behind Canada's controversial asylum policy

Get article background

SINCE the 2001 terrorist attacks, America has been criticising Canada for lax border controls, claiming they had turned the country into “a safe haven” for criminals and terrorists. Canada had seemed to ignore the charge. But on August 31st Stephen Harper's minority Conservative government proudly announced that, for the first time, 80 customs officers along its border with America had been equipped with guns in a first step to arming all its 4,800 border guards by 2017.

Despite government denials, all kinds of undesirables are getting into Canada under the country's dysfunctional “refugee” system. While doing little to save genuine refugees in camps abroad, it has opened the door to queue-jumping economic migrants, big-time crooks and terrorists, as documented in numerous reports (notably from the federal government's security service and auditor-general) over more than 20 years. In 1999, the Americans nabbed an Algerian asylum-seeker as he tried to cross the border from Canada with explosives intended to blow up Los Angeles International Airport.

Canada is the easiest country in the developed world in which to obtain refugee status. Most countries accept no more than around 15% of all applicants, whereas Canada accepts more than half. Attracted by an entitlement to the same legal rights and social benefits as for Canadian citizens, some 25,000 asylum-seekers make their way to Canada every year. Many come from safe, but less generous, third countries, often paying people-smugglers up to $50,000 each for false passports and airline tickets.

Once in Canada, they know they will be able to stay—and work—there for at least four years, while pursuing their appeals through the courts. Even if their claims are ultimately rejected, there is a good chance they will never actually be deported; the backlog of unexecuted removal orders is around 50,000. Many end up as citizens.

Canadians have become increasingly incensed by a series of high-profile cases of failed asylum-seekers who should be long gone. The most glaring is that of Mahmoud Mohammed Issa Mohammed, a Palestinian terrorist who took part in an Israeli airline hijacking; one passenger was killed. Ordered to be deported in 1988, he is still in Canada after some 30 appeals and reviews. Lai Changxing, one of China's most wanted criminal suspects, continues to launch appeals from his Vancouver home after being ordered to leave in 2000. And Rakesh Saxena, wanted in Thailand on embezzlement charges, who also lives in Vancouver, has been fighting extradition for the past ten years.

Remembering their own immigrant roots, most Canadians like to be generous to newcomers. But another refugee case, involving a paralysed Sikh, is beginning to test their patience. After entering Canada on a false passport in 2003, Laibar Singh applied for asylum, claiming that he would be tortured if returned to his native Punjab, where he was “falsely” accused of being a Sikh militant. His application was turned down, three times.

Last year, he suffered a stroke that left him paralysed, unable to feed himself and dependent on state-provided medical care. Faced with imminent deportation, he sought sanctuary in July in a Sikh temple near Vancouver, but was arrested when he went to hospital to get treatment. Last month Stockwell Day, Canada's public-safety minister, granted him a 60-day reprieve on “humanitarian” grounds, after the Sikh community had announced plans for a big protest demonstration. It is now widely expected that Mr Singh will end up being allowed to stay in Canada.

The main reason behind the refugee mess, critics say, is politics. If the Conservatives are to have a chance of forming a majority government after the next general election, they will need to pick up seats in Toronto, Montreal and Vancouver, where ethnic communities are concentrated. All three national

political parties pander to the ethnic vote. None wants to close the back door to new immigrants. Although the polls suggest that ordinary Canadians want the abuse to end, there is no political will. As James Bissett, former head of the Canadian immigration service, says: “It might take a bomb going off here to change this system.”

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Panama's Manuel Noriega

French leave

Sep 13th 2007 | MEXICO CITY
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A new cell for an old dictator

THE deposing of Manuel Noriega by American forces nearly two decades ago was an affair to remember. Paratroopers seized Panama's airfields. Mr Noriega holed up in the Vatican embassy. He eventually surrendered on January 3rd 1990. The invasion had been triggered by his indictment for drug trafficking, for which he was duly convicted by American courts.

On September 9th this year the former dictator finished serving 15 years in Miami. Having been accorded prisoner-of-war status, he was able to live in relative comfort; his cell had exercise equipment, a phone and a television. On finishing his sentence, he had been expected to return home, where he has been convicted of complicity in the 1985 murder of a political opponent.

But the government of Martín Torrijos seems hesitant to accept him. This President Torrijos is the son of Omar Torrijos, who ruled from 1968 to 1981 and was Mr Noriega's mentor. Though the government has called for his extradition, many suspect that Mr Torrijos is happy to see the former dictator sent to France, where he was convicted in 1999 on money-laundering charges. Mr Torrijos is a member of the Revolutionary Democratic Party (PRD), as was Mr Noriega; the newly-elected PRD speaker of the National Assembly is himself wanted by America on murder charges. Critics of Mr Torrijos say he would rather avoid the difficult questions that would be bound to be raised by Mr Noriega's return.

France has promised to allow the former dictator to continue to be treated as a prisoner of war. This clears the way for American courts to reject a series of appeals by his lawyers. He faces a ten-year term in France, making it possible that he will die before returning home. Were he to go first to Panama, he could not be sent to France, as Panama's constitution prohibits the extradition of its citizens. For the moment Mr Noriega remains in his cell in Miami, awaiting a final decision. As soon as Condoleezza Rice, America's secretary of state, signs a letter of extradition, he will be sent to Paris.

Mr Noriega is a nasty piece of work, but it took a while before his foreign mentors found it expedient to take notice. For many years he was a CIA asset. In 1987 France gave him the Légion d'honneur. Maybe he can wear it in jail.

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Japan

Abe leaves the stage

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From The Economist print edition

Reuters

Ill health and a newly energised opposition force the prime minister's exit

Japan's politics

BOWING to the inevitable, though with surprising timing, Shinzo Abe announced his resignation as Japan's prime minister on September 12th, after just a year in office. The grandson of a prime minister and son of a foreign minister who had missed his shots at the top job, Mr Abe had all his life been groomed to be prime minister—not least by his domineering mother, who last year insisted he grasp the chance even as grandees of the ruling Liberal Democratic Party (LDP) urged him to wait. In the event, it is hard to think of a less glorious term than Mr Abe's.

It had started on a high note. Mr Abe was relatively young—the first prime minister to have been born after the second world war. He had the nod from the outgoing prime minister, Junichiro Koizumi, who had dazzled the nation with his message of change. A year earlier Mr Koizumi had called a general election and won in a landslide, appealing over the heads of his party in favour of essential reforms, notably the privatisation of the postal-savings system, a fount of political patronage. Thanks to him, Mr Abe inherited not just a huge majority for the LDP-led coalition in the lower house of the Diet (parliament), but also a stronger office of the traditionally weak prime minister. Moreover, Japan's economy was returning to health after long years of slump. Mr Abe's government was initially very popular.

Yet the tide in Mr Abe's affairs only ebbed. True, early on he made a notable opening towards China, with whom relations had been strained under Mr Koizumi. Other than that, Mr Abe proved unable to impose discipline upon a cabinet of the corrupt and incompetent. Worse, he had a tin ear for the political mood. Voters, it had turned out, had been beguiled more by Mr Koizumi the messenger than by his message of structural reform, which entailed pain and uncertainty, notably in Japan's rural regions and among the old.

Mr Abe failed to address these concerns. Domestic policy interests him not a jot. Rather, he pursued a dogged passion for the symbols of a Japanese nationhood that he believes has been castrated by the country's pacifist constitution and abiding war guilt. Mr Abe's inert response to a bureaucratic scandal involving 50m missing pensions records underscored how out-of-touch he was. In late July voters punished his government in elections for the Diet's upper house: for the first time in its half-century life, the LDP and allies lost the upper-house majority, to the opposition Democratic Party of Japan (DPJ).

Not just the opposition but LDP heavyweights too began calling for Mr Abe's resignation. Many a prime minister had resigned for less. That he could claim that he would carry on was a measure of his party's disarray. On August 27th a cabinet shuffle replaced Mr Abe's callow band of brothers with a team of LDP heavies.

That seemed to buy Mr Abe time. Yet the DPJ's leader, Ichiro Ozawa, who vowed to destroy the LDP when he stormed out of it 14 years ago, still insisted his first priority was to topple Mr Abe. The fight he picked

was the extension of emergency “anti-terror” measures, due to expire on November 1st, which allow Japan to keep refuelling ships in the Indian Ocean. Ostensibly, Japan is helping American-led efforts in Afghanistan—absurdly, by providing free fuel for Pakistan's navy, hardly a frontline priority—though suspicions are growing that help has also gone to Iraq.

Mr Abe cares deeply about the presence: to him, it reaffirms Japan's alliance with America, the basis for the country's security, and proves Japan's readiness to play a more muscular role in the world. He argues that a pull-out of its ships would greatly harm Japan's international standing. No matter, says Mr Ozawa. Though long ago he had helped launch the debate about how Japan could play a more “normal” role in the world, the DPJ leader says that the Indian Ocean operation breaches constitutional limitations on collective self-defence. More than anything, though, Mr Ozawa's stand is tactical: his masterstroke is to have challenged Mr Abe on his own ground, by promising that the upper house would block any extension.

On September 12th Mr Abe claimed that his position was no longer tenable because Mr Ozawa refused to meet him. The claim is implausible, and the timing extraordinary: only two days earlier, Mr Abe had delivered his policy speech before the Diet. It suggests a sudden loss of political nerve. Ill health and exhaustion may have had a lot to do with it; on September 13th Mr Abe was hospitalised for tests.

To limit the enormous damage, the LDP now wants to find a swift successor as party president and therefore—thanks to the LDP's continuing majority in the lower house—prime minister. Party members will vote for Mr Abe's successor on September 23rd. The presumed favourite is Taro Aso, foreign minister under both Mr Koizumi and Mr Abe and currently the LDP's secretary-general. Urbane if with an earthy humour, Mr Aso is another prime minister's grandson and leads a small party faction. He could prove acceptable to the bigger factions if these were assured plum posts. But some members will argue that this back-room dealing is just what voters loathe about the LDP and will favour a Koizumi-style reformist.

More likely, perhaps, the party might conclude that Mr Aso's neoconservative views, which resemble Mr Abe's, are not what it needs right now. A caretaker prime minister might be put forward, such as Yasuo Fukuda, a grand old man of the party whose name crops up when the matter of the LDP's salvation arises. But no matter who is chosen, he will still face Mr Ozawa's dogged obstructionism. The opposition leader's tactics will come under closer scrutiny from voters now that Mr Abe is no longer the centre of attention. Still, he has destroyed the prime minister, as promised, and intends to fulfil his second promise: to make life hell enough for the LDP to force it to call a general election. It may be just a matter of time.

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The Philippines

Beyond impunity

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For once, a former president gets his comeuppance

Get article background

IT WOULD have been premature for President Gloria Macapagal Arroyo to celebrate the conviction of her predecessor, Joseph Estrada, for exceptional corruption, and she dared not do so. On September 12th, after a six-year trial, a special court found Mr Estrada, a former film actor, guilty of “economic plunder” during his presidency and sentenced him to life imprisonment. It ordered the confiscation of $87m amassed from protection money from illegal-gambling operators, embezzled tobacco taxes and commissions from insider trading. Two co-accused, including Mr Estrada's son, Senator Jinggoy Estrada, were acquitted. The ex-president, who pleaded not guilty and dismissed the case as politically motivated, said he would appeal.

Talking about the conviction, Mrs Arroyo's spokesman merely expressed the hope that the rule of law would prevail. The reticence stemmed in part from the fear that the ex-president's supporters might take to the streets. Mr Estrada still commands a huge following among the poor, who were enchanted by his cinema roles as champion of the underdog. They elected him president in 1998 by the widest margin in the country's history. When he was arrested, in 2001, they besieged the presidential palace, seeking to unseat Mrs Arroyo. To deal with any similar unrest after his conviction, thousands of police and soldiers were deployed in Manila.

EPA

Shades of the prison house

The government has some grounds for relief. As long as there was reasonable doubt about the ex-president's guilt there was also doubt about the legitimacy of Mrs Arroyo's rule. She took office in 2001, after evidence of Mr Estrada's wrongdoings provoked large protests on the streets of Manila and turned the army's top brass against him. He went unwillingly, insisting he was still the genuine president. Further doubt about the legitimacy of Mrs Arroyo's rule was created by allegations that she won the presidential election three years later by cheating. She denies this.

But Mr Estrada and his followers could still threaten the government. He will remain under house arrest while his appeal is heard. He has said he will not return to politics. But he will still be the main symbol of opposition. The government would probably pardon Mr Estrada if he left the country. He has said he has twice rejected offers of exile. Even if he goes, his son, Jinggoy, can remain as a rallying-point for his mass constituency, and a plausible contestant in the presidential election due in 2010.

The courts have burnished the Philippines' democratic credentials by showing that not even an ex-president is above the law—an example they notably failed to set after the fall of Ferdinand Marcos in 1986. Mrs Arroyo, hounded by accusations of electoral cheating and suspicions of corruption in her own administration, might have to ponder this thought should another Estrada ever come to occupy the presidential palace.

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Cambodia

Innocence for sale

Sep 13th 2007 | PHNOM PENH
From The Economist print edition

Ethnic discrimination fuels a vile trade

Get article background

THE virginity trade can sound as innocuous as the clink of ice in a glass. Roving young women equipped with ice buckets and tongs have long been a fixture of Cambodia's karaoke parlours. Now scores of “ice-pickers” are being groomed to supply a thriving market for virgins.

Capitalising on an influx of foreign visitors, Cambodia has become the region's prime destination for purchasing “unbroken” under-age girls. Among the foreign clientèle, the vast majority are Asian nationals: Chinese, Korean, Thai, and Japanese men who believe that deflowering a virgin will rejuvenate and purify them.

Meeting the demand is a growing number of ethnic Vietnamese—a group historically reviled by the ethnic-Khmer majority, but prized by the visitors for their pale complexions. Though ethnic-Vietnamese are estimated to make up no more than about 5% of Cambodia 's population—the government has never issued official figures—they represent almost one-third of virginity sales, according to “Ties That Bind”, a new study by the International Organisation for Migration (IOM).

Helen Sworn, of the Chab Dai Coalition, a network of Christian anti-trafficking groups, says that some are still trafficked across the border. But most are Cambodian-born daughters of Vietnamese migrants who arrived in the 1980s and 1990s, lured by the prospect of jobs. Many migrants have instead fallen into debt. They suffer discrimination from Khmers, who associate the newcomers with centuries of Vietnamese colonisation.

Entire families have chosen to build their livelihoods around the country's sex industry. “It's the bread-and-butter of daily life,” says one Vietnamese woman who sold her 14-year-old daughter to a brothel. “Most of us think it's just a job, a career to earn our living...And the girls try to do whatever their parents tell them.”

Such sordid realities were once in plain view, when notorious red-light districts were in full swing on the outskirts of Phnom Penh. But nearly four years ago, Hun Sen, the prime minister, led a much-publicised campaign to curb brothels. Resourceful traffickers, madams and pimps responded by pushing low-end sex work underground and infiltrating more up-market hotels, casinos and bars. So Keo Thea, of the Phnom Penh police's anti-trafficking division, says it is now harder to trace traffickers and their victims. “We need to dress our officers up like businessmen to reach them.”

Unlike in a dingy brothel, work in a boisterous karaoke parlour can appear to be voluntary. The girls are not locked up by managers who arrange to sell their virginity. But recruiters still routinely use deception and force, says the IOM, and the proportion of under-age girls is far higher, particularly among ethnic Vietnamese.

The repugnance the trade provokes among both local authorities and international aid donors has helped expedite the progress of a much-delayed anti-trafficking bill. Its passage would bring Cambodian law closer in line with international norms. Given the complicity of Cambodian officials in the sex industry, this would be no small accomplishment.

But such forward momentum is also undercut by Cambodians' popular disgust for the ethnic Vietnamese and the political acrimony they inspire. The migrants are routinely demonised by the opposition Sam Rainsy Party.

“They're an easy scapegoat,” says J.K. Reimer, a consultant to anti-trafficking groups in Phnom Penh. “There is the perception that Khmers have a higher standard of purity than Vietnamese—that the

Vietnamese are selling their daughters, but the Khmers are not."

San Arun, a senior official in the Women's Affairs Ministry, says the government holds no bias against trafficked Vietnamese. She cites an agreement with Vietnam to protect all victims, whatever their status. But without more concerted intervention, says Ms Reimer, the community risks becoming more ghettoised. The supply of girls—and the rings that traffic them—will be unbroken.

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Sex education in the land of the Kama Sutra

The birds, the bees and the taboos

Sep 13th 2007 | DELHI AND MUMBAI
From The Economist print edition

No sex please, we're Indian nationalists

BALU SUDHA, a teacher at a private girls' school in Mumbai, enrolled on a sex education course because she felt unable to answer her pupils' constant questions about sex. Her school, one of the city's poshest, invites an expert to lecture pupils on “those sorts of matters” two or three times a year.

That is more than most children in the state of Maharashtra, of which Mumbai is the capital, are getting. Sex education has never been Indian schools' strong suit, but earlier this year Maharashtra and eight other states rejected a new sex-education programme introduced by the central government. They included some of India's most populous, such as Gujarat, Madhya Pradesh and Uttar Pradesh, where one teachers' association threatened to make a bonfire of the new textbooks.

The attempt to make sex education universal in a country where sex is rarely discussed openly was always going to be tough. The course's euphemistic title—“Adolescent Education Programme” (AEP)—did not fool teachers, many of whom were horrified by a flipchart with illustrations of naked bodies and detailed drawings of genitalia.

Some also expressed anger over the inclusion of information on contraception and sexually transmitted diseases—the main point of the initiative. In India, 44% of reported AIDS cases occur among 15-29 year-olds. The involvement of the United Nations' Children's Fund, which developed the programme with the government, was another hurdle. It gave right-wing religious groups, always quick to make political capital from issues touching on “Indian values”, the chance to dismiss it as a Western import.

Nasratullah Afandi, of Jamaat-e-Islami Hind, an Islamic cultural organisation, says teaching sex education is part of an attempt to create a “homogenised culture”. “Anyway, sex is instinctive,” he adds. “It is not necessary to teach children about it.”

This highlights another problem: that many Indians have serious misconceptions about what sex education involves. As it happens, if they are given without publicity, sex-education classes can work in India. Since 1995, the Catholic church, which runs more than 100 schools in Mumbai, has taught a course that focuses on AIDS and other sexually transmitted diseases with no fuss at all.

But following the ruckus over the AEP, several states are tinkering with the course material. AIDS groups worry that this will involve stripping out the sex and focusing on “life skills”. The central government, meanwhile, has formed a committee to review its programme. It says it will reintroduce a watered-down version by the end of the year.

In Delhi the sex-education programme never reached any schools. Rina Ray, education secretary in the local government, said it would introduce its own course in November. It would emphasise “life skills: like nutrition, decision-making, and communicating with one's parents”. It did include information about sex and AIDS, she added. “But we're the education department, not the health department.”

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Inflation in China

An old worry nags again

Sep 13th 2007 | BEIJING
From The Economist print edition

Rising prices alarm the Communist Party ahead of its five-yearly congress

Get article background

CONSUMERS in China's cities have had it good for an unusually long time. During most of the past few years of double-digit economic growth, inflation—at least according to official figures—has been barely detectable. But data published this week show the biggest monthly rise in consumer prices for over ten years. Government officials are getting worried that China's happy spenders will turn angry.

The latest figures were higher than many had expected. The National Bureau of Statistics said that consumer prices rose 6.5% in August compared with a year earlier, up from 5.6% in July. Officials still insist that the recent price increases are not a sign of widespread inflation. So far, they say, the index is being driven up by food prices, particularly pork. If food is excluded the index rose by a mere 0.9% in August. But nerves are fraying. Inflation always scares the Communist Party. Hyperinflation helped its own rise to power in the 1940s; price increases fuelled the pro-democracy unrest of 1989.

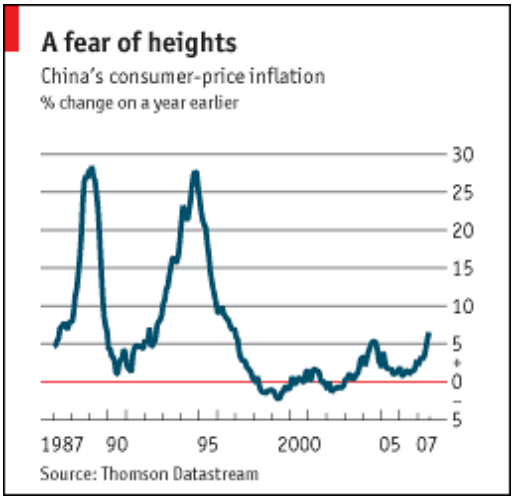
The timing of this price surge is unfortunate for President Hu Jintao. Since becoming party chief in 2002 and president in 2003, he has presented himself as a champion of the poor. The urban middle-class may shrug off rising food prices, but the poor are being hit harder. From October 15th Mr Hu will preside over his first party congress since assuming the leadership. He does not want it marred by public grumbling, let alone protests. In the build-up to the congress, local officials, citing the need for “stability”, have been issuing flurries of directives calling for measures to tame prices.

Pork is the focus. At the end of August it was 70.3% more expensive than it was a year earlier in 36 large cities surveyed by the National Development and Reform Commission (NDRC), the economic-planning ministry. Officials blame rising animal-feed prices and the death or culling of millions of pigs after an outbreak of disease. Officials say pork prices have stabilised since the middle of August. But demand will surge during festivals in the coming weeks. Pork is a staple food for most Chinese.

Other food is becoming dearer too. The prices of eggs, poultry and edible oil rose some 20% or 30% in big cities in August compared with a year earlier. Overall the food-price index rose by 18.2% that month. Central and local governments have responded with new subsidies to encourage peasants to raise more pigs and cushion vulnerable groups from price rises. Among those receiving handouts are those on poverty-relief schemes, army units and poor students. In Beijing this week officials banned price increases in university canteens. A state-owned newspaper reported complaints by students in Shenzhen, which

borders Hong Kong, that canteens have been cutting portions to save money.

The NDRC has promised not to intervene directly in setting prices. But it has ordered a crackdown on merchants or producers who are “fixing prices”. Price-rigging is probably often more imagined than real. Local governments can gain popularity by using anti-cartel regulations to bully sellers into keeping prices down. But free-market instincts still run deep. Many newspapers heaped scorn on the city of Lanzhou after it ordered a cap on the price of beef noodles in June.



Local governments have reason to fret. Even before food-price inflation became apparent early this year there had been reports of price-related unrest. In March riots erupted in Zhushan village in Hunan after a bus fare was increased from seven yuan (about 90 American cents) to nine. Riot police armed with batons clashed with thousands of farmers, leaving one person dead. In October 2006 hundreds of people rampaged through a hospital in Sichuan and fought with police after a boy died because (the protesters believed) his father could not afford the treatment.

Even members of Beijing's middle class complain. Although the consumer-price index has long been growing in low single digits, many say that it does not accurately reflect the increasing burden. Yi Xianrong of the Chinese Academy of Social Sciences says housing costs, which have been rising fast in many cities in recent years, are not given due weight in the index (food accounts for a third of the index and housing less than 14%). He says local governments, which benefit hugely from rising property prices, have been far more reluctant to investigate price-fixing allegations in that sector than they have in the case of food.

If there is one source of relief for the party it is that China's consumers have not been swept up by a recent surge of discontent abroad over safety standards of Chinese products. Consumers in China, where the market is subject to far less rigorous quality controls, should have more reason to complain than those overseas. They have to contend with pork that is sometimes injected with water to make it heavier or, worse still, with poisonous chemicals to make the meat less fatty. Hundreds of people in Shanghai fell ill last year from such meat.

A muzzled press and a lack of independent consumer-rights organisations help suppress this sort of bad news. Zhou Qing, who wrote a book published this year on the dangers of food sold in China, says officials have tried to curb its circulation (his dissident past may not have endeared him to them either). Mr Zhou suspects that the high price of pork will encourage more doctoring of meat.

Officials predict that the consumer-price index will rise by around 4% this year as a whole. This is still tame compared with the double-digit peaks of previous inflationary periods in the past two decades. Neither is it far off the target of less than 3% set at the beginning of the year. Officials say subsidies aimed at encouraging pig-rearing should cause the pork shortage to ease by the middle of next year. But some still fear more general inflation. Efforts this year to curb liquidity and a surging economy—including four interest-rate rises and seven increases in the amount of money commercial banks must deposit at the central bank—have shown few results. As he prepares for his big moment at the party congress, Mr Hu will not be at ease.

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Iraq

Please go, some time

Sep 13th 2007 | BAGHDAD
From The Economist print edition

Getty Images

While Americans argue over how and when to bring their boys home, the Iraqis have their own equally mixed views

Get article background

PREOCCUPIED with just staying alive, most Iraqis seemed to pay little attention to this week's testimony before Congress by General David Petraeus, the American commander in Iraq, and Ryan Crocker, the ambassador. But the brouhaha leading up to the event sent a shudder through Iraq's politicians, as they realised that their actions—or inaction—could prompt an American exit sooner rather than later. Where would that leave them?

After months of failing to meet the benchmarks set by the American Congress to assess whether it was a good idea for American troops to stay in Iraq in large numbers, the politicians in Baghdad have been scrambling to give an impression of progress. Last month leaders of parliament's five biggest blocks said they had agreed to settle a clutch of tricky issues—from sharing oil revenues to the rehabilitation of purged former Baath party members—but have yet to reveal the details.

More recently, one of the tougher Sunni-led groups, the National Dialogue Front, ended its months-long boycott of parliament. It lauded American efforts to combat Shia militias and to work with Sunni tribes, and said the Americans had started to be “fair” in their dealings with Sunni Arabs, Shias and Kurds. Even the fiery Shia clergyman, Muqtada al-Sadr, who has long wanted the Americans to get out fast, told his Mahdi Army militiamen to cease armed activity for six months, though exactly why is not yet clear.

In the past, Iraqi leaders have often sounded resentful about those benchmarks, damning them as assaults on Iraq sovereignty. Yet most parties, bar the Sadrists and the Sunni insurgents, say they do not want a hasty withdrawal. They fear it would precipitate an even ghastlier wave of bloodshed across the country.

The Kurds are probably the only big Iraqi group that actually wants the Americans to stay for long, but the Shia parties that dominate the government accept that Iraq's fledgling army still needs American training and cannot yet cope on its own. Sunni Arab politicians tend to favour a continuing American presence even more strongly and openly these days, since General Petraeus's “bottom up” strategy of bypassing the central government and helping tribes to organise their own paramilitary forces seems to be working. In any event, virtually all the established leaders, even Mr Sadr, may calculate that their survival is best served by the status quo, and that a rapid American withdrawal may bring a maelstrom of upheaval that would see them shoved aside.

Iraq's people, however divided, seem keener for the Americans to go. A poll carried out by the BBC, ABC and a Japanese broadcaster, NHK, found that some two-thirds of them said the surge had hurt security and political stability and slowed development. People in Baghdad, especially Sunnis, seem a bit keener on the surge, which has been concentrated there, but are still far from hopeful. Quite a few shops have reopened, and trade thrives on market streets that were recently deserted.

The Sunni insurgents may be a bit less active because they are watching developments in Anbar province, to the west of Baghdad, where the Americans are helping Sunni tribes to set up paramilitary forces. The Americans want them to fight al-Qaeda there, but many Sunnis may be hoping to get American backing for their efforts to weaken Shia control of Iraq.

The Shias are less happy. Their militias now rival the Sunni insurgents as the American army's main adversary in Baghdad; the American deputy commander recently said that Shias caused 73% of all the capital's casualty-causing attacks in July. Some areas are riven by an increasingly bitter feud among Shias, between the Mahdi Army and its rival, the Badr Brigades of the Supreme Islamic Iraqi Council, a major party in the government. Some residents in Sadrist areas say that the Mahdi Army has become steadily twitchier as it feels the weight of the American crackdown and that people are frightened of speaking to strangers in case they are thought to work with the Americans or harbour sympathy for the Badr Brigades.

Meanwhile, other less political grievances abound. Electricity does not work in most parts of the capital most of the time. Sewers overflow. The official price of petrol has jumped 20-fold since the Americans took Baghdad in 2003.

Nuri al-Maliki's shaky government has broadly welcomed the Petraeus report. His national security adviser, Muwafaq al-Rubaie, even suggested his own timetable for withdrawal. America, he said, should have fewer than 100,000 troops in Iraq by the end of 2008, provided that Iraq's own forces were ready and that security had improved: that is not far from what General Petraeus himself seems to want.

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Israel and Syria

Mysterious happenings

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From The Economist print edition

Talk of war, talk of peace

“I CAN'T remember a time when our interests and theirs converged like this,” says a former Israeli defence man. For several days after Syria complained that Israeli aircraft had penetrated its airspace, neither country wanted to talk about what had happened. The unaccustomed silence was broken first by Syria's foreign minister, Walid Moallem, who apparently complained to European diplomats that Israel had bombed targets in Syria; and then by unnamed American sources, who confirmed to CNN and the *New York Times* that Israel had carried out air strikes.

What Israel bombed and why is still unclear. The American reports suggest that it was weapons destined for Hizbullah, the Iran-backed Islamist Shia movement that dominates southern Lebanon, but these have been passing through Syria for years. One theory is that it was suspected nuclear material from North Korea (apart from Iran, North Korea was the only country to leap indignantly to Syria's defence); another, that Israel was trying out flight paths for a possible war with Syria or attack on Iran, or testing out new Syrian air defences that were reportedly recently supplied by Russia. Syria's own muted response and failure to retaliate suggest that whatever happened, it was most embarrassing.

Certainly, Israeli air force officers are said to be jubilant about the mission's success, though officials have stayed tight-lipped, and those Israeli journalists who hint that they know what happened aren't telling. Whatever the target, it must have been something special for Israel to launch an attack now, at a time when both countries have been building up their forces for a possible war while trying to reassure each other publicly that they do not want one. Indeed, having the leaks come from America rather than Israel may have been an attempt to avoid further escalation.

That attempt may be working: despite unconfirmed reports that Syria was calling up its reserves, no firm promise of military retaliation has come. And the raid will certainly have given Syria pause. Though both countries have been building up their defences since Israel's war with Hizbullah last summer, Syria has for a while been calling for new peace talks over the return of the Golan Heights, which Israel occupied in the 1967 war. A number of prominent Israelis echoed that call this year, after a former Israeli diplomat and an expatriate Syrian-American revealed that they had had a series of meetings to talk peace.

Proponents of talking to Syria argue that doing so would encourage it to reduce its involvement in Lebanon, loosen its ties with Iran and stop letting insurgents cross its border into Iraq. Sceptics, who predominate in the Israeli and American governments, argue that Syria merely wants peace talks with Israel as a way to ease the pressure on it, and should show it is serious about relinquishing its influence in Lebanon first. The latest raid may have weakened Syria's hand. If Israel can slow Hizbullah's arms supply or foil Syrian air defences, then, so the theory goes, it dents Syria's ability to use either its influence in Lebanon or the threat of a war with Israel as bargaining chips.

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Israel

Home-grown Nazis

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A nasty surprise in Israel's midst

ISRAELIS were shocked, as was the rest of the world, by the news that police had arrested a gang of young neo-Nazis in Petah Tikva, near Tel Aviv. The eight, all immigrants from the former Soviet Union and all but one of them non-Jewish, had taken photos and videos of themselves giving Hitler salutes and beating up foreigners, drug addicts and skullcap-wearing religious men, and had swapped anti-Semitic e-mail messages.

Shocking—but not all that surprising. Israel's “law of return” allows not only Jews but their partners, children and grandchildren, who may not be technically Jewish, to claim Israeli citizenship. It drew immigrants from the former Soviet Union, causing many with only a tenuous Jewish link to move to Israel for a better life. But they often found it hard to get good jobs, so many of their children have grown up in poor towns with few opportunities. And non-Jews in Israel face various complications—from social exclusion to trouble getting married in a country where the rabbinate will not marry non-Jews but civil marriage does not exist. It was likely that a few disillusioned and susceptible youths would fall prey to extreme ideologies.

EPA

Yes, an Israeli neo-Nazi

Nor is the phenomenon new. The past few years have seen a steady trickle of anti-Semitic attacks and swastika-daubings by Israelis, and several youths have been arrested. What grabbed attention this time was the videos they made. Dmir, an organisation that has campaigned for the past seven years for victims of anti-Semitism in Israel, reports hundreds of complaints a year.

Some politicians said the law of return should be more restrictive, which naturally infuriated Russian-Israeli leaders. Arab-Israelis, meanwhile, compare the fuss over the neo-Nazis with the indifference to another extremist minority—those among the right-wing Jewish settlers in the Palestinian territories who have spread hate and carried out attacks against Palestinians but are rarely punished. Jamal Zahalka, an Arab member of parliament, put it succinctly: “You can't discriminate between racists.”

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Iran

In the crossfire

Sep 13th 2007
From The Economist print edition

When inspectors compete with the diplomats over nukes

Get article background

AS TOUGH as the diplomatic effort to talk Iran out of enriching uranium and producing plutonium has proved, the going just got tougher. A row over how to deal with its defiance bubbled over at this week's 35-nation board meeting of the International Atomic Energy Agency (IAEA), the UN's nuclear guardian. Expect more heated exchanges when world leaders gather shortly for the UN General Assembly. Strains are already evident among the six—Britain, France, Germany, the United States, Russia and China—that have led the Security Council effort to get Iran to suspend its offending nuclear work. America has called all six together on September 21st to discuss tougher sanctions.

In a controversial “understanding” with Iran, IAEA inspectors agreed last month to a work plan to get answers about past safeguards violations. These include: experiments with materials potentially of use in bomb-making; unexplained traces of enriched uranium; black-market purchases of more advanced uranium-spinning centrifuge machines than are being installed at Iran's enrichment plant at Natanz; and documents, connections and design work that point to a weapons effort.

But the IAEA's deal raises two dangers. First, Iran may simply string out incomplete answers, while continuing to hone its enrichment skills at Natanz and pressing ahead with work on a plutonium-suited reactor at Arak, another site. Only when inspectors have “closed the file” on one issue, will Iran address the next. In the agreement Iran also insisted on describing as “baseless” accusations about military aspects to its nuclear work. So the inspectors may get some answers, but not all.

Another danger, say critics, is that the IAEA's director-general, Mohamed ElBaradei, is using the deal with Iran to intervene directly in the policy debate, rather than limiting himself to an impartial look at the safeguards facts. Mr ElBaradei may think he is making space for diplomacy. But easing the squeeze on Iran may well make it harder to find a diplomatic solution.

It doesn't help that Mr ElBaradei insists publicly that it is pointless trying to end all enrichment work in Iran, and that a better solution would be to negotiate limits on that work. Here, say Western diplomats, he is both wrong in substance and misguided in tactics. Iran has an obligation, set out in Security Council resolutions, to come clean about its nuclear past. Yet those same resolutions also require it to suspend all uranium and plutonium-related activities, until confidence in the peaceful nature of its nuclear activities is achieved. After a barrage of criticism, Mr ElBaradei acknowledged that this week.

Meanwhile, by acting as a diplomatic player with an agenda of his own, Mr ElBaradei risks seeming to politicise the work of the IAEA. He has reportedly given private assurances that Iran will not be allowed to spin out its answers, and that it will be clear by November whether it is co-operating fully: its “last chance”, he says. But how much co-operation is enough? Not a proper judgment for inspectors, or for their controversial boss.

In Israel, which feels directly menaced by Iran's nuclear ambitions, Mr ElBaradei's efforts to portray Iran's nuclear programme as too far gone to stop hardly makes a case for prolonging diplomacy. America, like the Europeans, says it is still firmly committed to the UN diplomatic track. But using Mr ElBaradei as cover, Russia and China are again dragging their feet over further sanctions. The longer Iran is left enriching with impunity, the greater the risk that someone's patience will eventually snap.

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Zimbabwe

Checkmate for the archbishop

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A prominent critic of President Robert Mugabe resigns

THE Archbishop of Bulawayo, Pius Ncube, has joined the crowded ranks of those felled for speaking out against Zimbabwe's president, Robert Mugabe. In July, the state-run media aired photographs that they said showed the archbishop in a compromising position with a married secretary of his parish.

His supporters said it was a conspiracy to discredit him; Zimbabwe's Catholic church also stood by him. For many years he has criticised Mr Mugabe's regime in the strongest possible terms. But this week, facing adultery charges in court, he stepped down as archbishop of Zimbabwe's second largest city, denouncing the “crude machinations of a wicked regime”.

Reuters

Will his voice still be heard?

The 60-year-old explained his decision as a move to protect his fellow bishops and the Catholic church. The government said his resignation was an admission of guilt. Some people believe he was, indeed, the victim of a cleverly-sprung government honey-trap.

Earlier this year, after opposition leaders had been arrested and beaten up, he called for street protests and, later, for foreign intervention to oust Mr Mugabe. He also said he was praying for the president's death. Mr Mugabe, himself brought up as a Catholic, told clergy who spoke out against him that they were on a “dangerous path”.

Archbishop Ncube, who took up his post in Bulawayo in 1997, is an Ndebele whose homeland, in western Zimbabwe, was subject to the government's brutal repression in the 1980s, leaving many thousands of people dead. He said he would remain a Catholic bishop and would not be silenced. But it is unclear whether he will retain his moral authority.

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Zimbabwe

Blackening the economy

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A new bill is supposed to give black Zimbabweans more economic power

Get article background

DOING any business at all in Zimbabwe is no mean feat these days. Sky-rocketing inflation— officially estimated at 7,600% in July but probably over 10,000%—unemployment at 80% and crippling power and fuel shortages are daunting enough. On top of that, price controls slapped on in June have emptied shelves and depleted stocks, bringing many shops and factories to a standstill. The official exchange rate was devalued last week from 250 to 30,000 Zimbabwean dollars to the American one. But this new rate is still at least eight times less than what you can get on the black market. Now, following the land redistribution that has devastated agriculture, President Robert Mugabe's government seems to have declared open season on other parts of the economy as well.

In the next few weeks, Parliament looks set to pass the Indigenisation and Economic Empowerment Bill that might ultimately transfer at least 51% of all businesses into local black hands. This is in addition to a law which already reserves 60% of most listed companies to local blacks. Zimbabwe's government is not the only one in the region trying to involve more blacks in the economy, none more so than South Africa with its “black economic empowerment” programme. But Zimbabwe's is probably the only one so far to declare, in effect, that whites or foreigners should not own more than half of a company. The bill defines indigenous as “any person who before the 18th April 1980 [Zimbabwe's Independence Day] was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person.”

In any event, Zimbabwe's bill contains a lot of ambiguity, and gives a lot of loosely-defined discretion to the government. It is unclear whether the transfer would apply only to future mergers, demergers, restructurings and transfers, or to all existing companies. Moreover, the minister for indigenisation and empowerment would have to approve all ownership transfers and would have the power to impose alternative local partners if he disapproves of those involved in the proposed transactions. He would also have the authority to exempt selected companies from the ownership requirements for a certain period. Though the bill says little about compensation, there is a proposal for a fund that would help Zimbabweans finance their acquisitions through, among other things, a company levy. So businesses may end up paying for their own change of ownership.

In the past, similar threats to indigenise parts of the economy have come to nothing, so there is still a chance the bill will be quietly buried. However, its appearance now is hardly likely to delight new investors. For example Orascom Telecom, a mobile-phone group based in Egypt, is already fighting to protect its investments in Zimbabwe. It owns 60% of Telecel, a local operator whose licence the government threatened to cancel unless Orascom reduced its ownership to 49%.

Other companies are trying to head off the threat by taking the initiative. Old Mutual, a financial institution with roots in South Africa, has just said it would sell 20% of its Zimbabwean operation to local staff, though it maintains this has nothing to do with the bill. Edcon, one of South Africa's biggest retailers, donated part of its business in Zimbabwe to local staff a few years ago, bringing its share down to 40%.

South Africa's Standard Bank and Britain's Barclays, which own all or a majority of their Zimbabwean subsidiaries, are taking a wait-and-see approach. But Heinz, a food giant involved in Zimbabwe since the 1980s, announced last week that it had sold its 51% stake in Olivine, a company dealing in cooking oil, margarine and soap, to the government. It will leave Zimbabwe altogether. Most investors, however, are hoping to hang on until Zimbabwe turns the corner and starts rebuilding its once flourishing economy.

On the other hand, the country's economic crisis is also attracting investors keen to pick up cheap assets. But they need a big appetite for risk. Earlier this year, Lonrho, a conglomerate with a long history of

trading in Africa, announced the creation of a Zimbabwean subsidiary that would primarily invest in property, infrastructure and hotels. LonZim has already raised over £32m ($66.2m) and is expected to list in London shortly to bring in more cash.

Imara, a financial company focusing on Africa, opened a fund investing in Zimbabwean firms in April. But the money poured in faster than it could invest, and it had to stop taking new money for a month in May. The fund has now invested $12-13m mainly in companies listed on the local stock exchange—a novel form of disaster investment.

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Niger

A radioactive rebellion

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A combustible mix of rebellious nomads, uranium, oil and poverty

THE last time there was a crisis in the landlocked Saharan country of Niger, the president claimed his people were well-fed, yet images of skeletal children shocked the world and aid workers scrambled to deal belatedly with a famine. That was two years ago. Now nomadic rebels have taken up arms again in the north, but President Mamadou Tandja says they are nothing but a bunch of bandits.

It is a lot more menacing and complicated than that. Seven months after its first attack on Niger's army, the Niger Movement for Justice (MNJ) is rattling Mr Tandja. Fifty government soldiers have been killed and dozens more kidnapped. The entire north has been turned into a battle zone, with army checkpoints and both sides laying landmines. Charter flights no longer bring tourists to gaze at the dunes.

Even if the president does not openly recognise the gravity of the rebellion, he is plainly determined to crush it. He has dispatched 4,000 soldiers to the northern region of Agadez. On August 24th he declared a state of alert, giving them a free rein to operate. Television and radio stations have been banned from discussing the crisis live on air and journalists are barred from going near the affected area. “You can't report up there: there's a blackout,” an official told *The Economist*'s correspondent when he asked for accreditation.

This rebellion is the latest in a series of uprisings led by the Tuareg. They are Saharan nomads who were split up between five post-colonial countries (see map). Long complaining of neglect, they first rebelled against their new masters in the 1960s, in Mali. In the 1990s they again rebelled there and also in Niger. Both countries are now dealing with fresh revolts that are loosely connected.

Depicted by some as simple nomads wandering around the desert on camels or motorbikes, in fact the MNJ is well organised. Heavily armed and guided by GPS systems and satellite phones, its guerrillas launch lightning attacks before fading back into the desert sands. The MNJ's contacts in Europe or underground in the capital, Niamey, then inform the world via the group's website. Keen not to depict themselves as a purely Tuareg movement, the rebels say they want a fairer slice of the country's wealth, especially from its gold, oil and uranium, all found in the north. The UN rates Niger, despite its natural resources, the poorest country in the world.

While Mr Tandja sounds firmly against negotiation, some people in and outside his government may be readier to talk. But he is under pressure from his southern-dominated army not to give ground.

The conflict could spread

Regional politics are also at play. Neighbouring Libya has a longstanding territorial dispute over Niger's north and many in Niamey, including some in the government, accuse Muammar Qaddafi and his regime in Tripoli of backing the revolt.

Uranium is a big factor too. With more governments around the world planning for nuclear power and Niger producing some 3,500 tonnes of uranium a year, the apparently empty wastes of northern Niger are suddenly worth fighting over. A French nuclear company, Areva, which operates in the north but recently lost its 36-year monopoly, has been labelled sympathetic to the rebels, who recently seized a Chinese uranium worker, presumably to deter China from backing Niger's government. Niger's uranium production is still going up; 90 new exploration permits have been handed out in the past year.

The Sahara is also at the centre of an American initiative to stop terrorism getting a foothold in Africa. But apart from the odd smuggling deal over guns, drugs or cigarettes, no solid links between the Tuareg and Islamist groups have been established. Still, Western governments may have to take the rebellion seriously. It is unlikely to be squelched by military means alone. Muhammad Anacko, a former rebel leader in the 1990s who is now Niger's commissioner for peace, is calling for dialogue. The rebellion “may last five years or 15 years but it will end in talks,” he says. “Why don't we just go to them now?”

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Russia's government

Comrade Who?

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AP

Why Russia's president has picked such an obscure new prime minister

INTERNET search engines had a busy time looking for the name (and even picture) of Viktor Zubkov this week. Any government shake-up provokes questions, but rarely such a resounding one of “Who?” That was the general cry on September 12th, when President Vladimir Putin announced that the uncharismatic Russian prime minister for the past three-and-a-half years, Mikhail Fradkov, was resigning, to be replaced by Mr Zubkov (shown above, with Mr Putin, in 2004).

The superficial answer to the question is that the 65-year-old new prime minister, who was due to be confirmed by the lower house of parliament, the Duma, this weekend, is a former collective-farm manager who worked with Mr Putin in the 1990s in St Petersburg. He now heads the government's financial-crimes agency.

Yet the deeper answer is that the choice of Mr Zubkov is just one more instalment in the Kremlin's byzantine manoeuvrings to decide who will run Russia when Mr Putin steps down at the end of his second term next March. That is why Kremlinologists had expected a government upheaval this month, three months ahead of the parliamentary election and six months before the presidential election.

After all, there was no particular government crisis. As prime minister, Mr Fradkov, a former trade negotiator, was a study in obedience to Mr Putin. Unlike Mr Zubkov, his career shows obvious signs of a period working for the security services. Yet the grey Mr Zubkov is unlikely to prove a very different kind of prime minister.

The cabinet shuffle is better seen as part of the opaque selection process known as “operation successor”. Observers had expected Mr Fradkov to give way to one of the men Mr Putin has publicly groomed to take over. These are the two first deputy prime ministers: Sergei Ivanov, a suave KGB veteran and former defence minister, and the more bookish Dmitry Medvedev, a lawyer who chairs Gazprom and runs special projects for Mr Putin.

Neither of the two men has ever held any kind of elected office. Yet a concerted state media campaign has turned them into the country's best-known politicians after Mr Putin. Indeed, the speculation over whom Mr Putin might favour had become so feverish that *Vedomosti*, a usually well-informed newspaper, excited Moscow's chattering classes on the morning of September 12th with an anonymously sourced article predicting that Mr Ivanov was about to replace Mr Fradkov.

Once Mr Ivanov became prime minister, the story went, the game would be over: he would clearly then become president next year. Any opposition to the Kremlin has already been firmly squashed—and in any case Russian voters, who still give Mr Putin an approval rating of over 80%, would certainly respect his

wishes. There is, moreover, a precedent: Mr Putin himself, then an obscure ex-KGB lieutenant-colonel, was chosen by Boris Yeltsin to be prime minister in August 1999 and went on to succeed Mr Yeltsin as president at the end of the year.

On this basis, the unexpected choice of Mr Zubkov bears three possible interpretations. One is that Mr Putin simply wants to keep the world guessing, before plumping for one of the two front-runners. A second is that he has a wholly different successor in mind—who might be Mr Fradkov himself (or, even more surprisingly, Mr Zubkov). The third is that Mr Putin has not yet decided who it should be. “This isn't a solution, but a way of putting off the solution until later,” concludes Yulia Latynina, a political commentator.

Some other analysts offer a fourth idea: that Mr Putin may be laying the groundwork for staying on after March 2008. Ways might be found round the constitutional limit of two consecutive terms. One might be to arrange for a straw man to win the election and then step down, paving the way for Mr Putin to return triumphantly in a snap election. A second might be to transfer the presidency's power to another job. “I think Putin will stay, either through elections or without,” says Yevgeny Volk, of America's conservative Heritage Foundation. “There are strong forces that need him to stay.”

In truth, though, as Masha Lipman, of the Carnegie Moscow Centre, comments, today's Kremlinologists are little more reliable than were their predecessors, who would spend hours minutely scrutinising photographs of the politburo at Red Square parades. “We are involved in deciphering signals from above. It's total opaqueness in decision-making. It signifies the separation of the state from society.” That is unlikely to bother Mr Putin, or his chosen successor, too much.

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Sweden, one year on

Moderate revolution

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The centre-right government is proving highly cautious over reform

IN A country ruled by Social Democrats for 65 of the past 75 years, the election 12 months ago of a centre-right government was seismic. Normality has returned: the four-party coalition, led by Fredrik Reinfeldt of the Moderate Party, trails the Social Democrats in polls. That reflects a new Social Democratic leader, Mona Sahlin, with greater voter appeal than her predecessor, Goran Persson, who led his party to its worst defeat since 1914. But it is also because Swedes are not enthused by their youthful but colourless prime minister.

Mr Reinfeldt had a bumpy start, losing two female ministers to scandals in his first few weeks. Since then he has kept a determinedly low profile, while assiduously touring the country to meet voters. He admits that he is “not a media star”. As for leadership, he declares that it “is about going through all the doors of Sweden and finding out what people want.” That sounds more like followership. It is certainly not a recipe for radical change. And yet, despite the Social Democrats' present edge, it may prove enough to win the centre-right re-election in three years' time.

One explanation for this is the economy. In 2006 GDP grew by 4.5%, and it will probably rise by another 3.7% this year. In every year bar one since the euro's launch in 1999, Sweden (which, like Britain and Denmark, stayed out) has grown faster than the euro area. Yet Mr Persson's defeat was partly about economics. Fast growth hid two failings: a lack of jobs and exclusion from the workforce of many young people and minorities. Although official unemployment is only 5%, the IMF says a fifth of the working-age population is “economically inactive”. Anders Borg, the pony-tailed finance minister, sees the exclusion of a large group from the labour market as his biggest problem.

As a good liberal economist, Mr Borg has set about improving the incentives for employment. Strong public finances have let him reduce taxes on the low-paid and bring in a tax credit. He has also cut unemployment benefits, annoying the unions. But he is not about to embark on substantial labour-market reform or an attack on the bloated public sector.

Asked why not, Mr Borg insists that labour laws are already relatively liberal. He concedes that unions are strong (90% of employees are covered by collective bargaining, compared with 30% in Britain and 14% in America), but says they are also responsible. As for the public sector, he is pushing privatisation and competition. He points to Swedish health care, where output has risen but spending has stabilised, as a model. He wants to cut taxes and spending, but only “in an orderly and well-structured way”. His message is of “peaceful social engineering”, not revolution.

Mr Borg is the government's strong man on domestic policy (he just won a budget fight that led to the defence minister's resignation). On foreign policy, that role devolves on Carl Bildt, the impressive and much-travelled foreign minister, once himself prime minister. Both men seem more forceful and charismatic than Mr Reinfeldt. Yet the prime minister's role in holding together the coalition is vital.

The centre-right was mauled in 2002 when it promised an assault on Sweden's social model. Mr Reinfeldt, who took over as party leader in 2003, learnt from that. He rebranded his party the New Moderates and pulled his coalition partners into an alliance with a single platform. Bold moves such as joining the euro or, one day, NATO, which he favours, remain off the agenda, at least for now. As he expresses it, “we are not pushing a neo-liberal reshaping of Swedish society. People don't like revolutions. If you ask somebody, do you want change, he will say that my neighbour needs it, but not me.”

To Mr Reinfeldt's satisfaction, the modest reforms pushed through by Mr Borg are already producing more jobs. Similar changes to foster entrepreneurship may yet bear fruit. Sweden has many world-class, export-oriented companies that are well placed to take advantage of globalisation. Swedes are well-educated, English-speaking and at ease with high technology. With a booming world economy, such advantages augur well for growth.

Yet there lies a caveat: the world economy may not keep booming. The European Commission has just downgraded its growth forecasts. America, which is Sweden's biggest export market, is teetering on the edge of recession. The two previous periods of centre-right government, in 1976-82 and again (under Mr Bildt) in 1991-94, expired after a nasty bout of world recession. Social Democrats claim that this experience shows that the right cannot be trusted on the economy. What it actually demonstrates is how vulnerable Sweden is to a global slowdown. Moreover, it was the Bildt government that initiated the reforms that led to a strong recovery under Mr Persson in the late 1990s.

For now Mr Reinfeldt is sitting quite comfortably. But a sharp global downturn would test his leadership more than anything he has met so far. It could also mean that he and Mr Borg might regret not pressing ahead with bolder reforms when the economic climate was more benign.

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Muhammad cartoons in Scandinavia

Gone to the dogs

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From The Economist print edition

Is it déjà vu all over again?

FOR the past few weeks Sweden has been poised for a replay of the Muhammad cartoon row in Denmark in 2006. *Nerikes Allehanda*, a provincial newspaper, published a crude sketch of the head of the prophet on the body of a dog. But despite a few flag-burning incidents in Muslim countries, some noisy protests in Sweden and a clutch of reprimands by Muslim governments, the response has so far been muted.

The affairs had similar incendiary ingredients: rude newspaper cartoons, outraged Muslims and secular Scandinavians insisting on freedom of speech. Yet there were also differences. Sweden had the benefit of hindsight. Denmark's sluggish response was a textbook case of muddled policy. The Danish case meant that the Swedes were acutely aware of the cartoons' inflammatory potential from the moment they appeared.

Fredrik Reinfeldt, the Swedish prime minister, waited weeks, not months, to publish an official statement that both defended free speech and expressed regret that people had been offended. And unlike Denmark's prime minister, Anders Fogh Rasmussen, who haughtily declined to meet a delegation of Muslim ambassadors, Mr Reinfeldt took the initiative to invite them in for a chat.

The political context is also different. The “foreigner problem” has topped Denmark's agenda for six years; an anti-immigration party is the government's bosom ally. In Sweden there is more concern about jobs and money. And Sweden is a more inclusive place (the minister for integration is from Burundi).

And then there is the genesis of the cartoons. The Danish ones were the work of a dozen artists, commissioned by a big newspaper. The Swedish cartoons are by one man: Lars Vilks, a former art professor and maverick. Before now, his most famous creation was Ladonia, a fantasy country in a Swedish nature reserve. Mr Vilks claims that over 3,000 Pakistanis applied for citizenship of Ladonia in 2002 alone. All the more reason not to take him too seriously.

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Italy's public finances

Taxing

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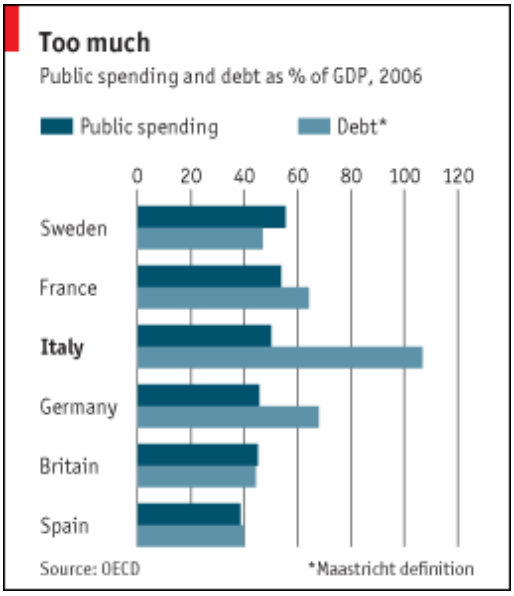
A surprising boost in revenues fuels a debate about tax cuts



BY THE standards of his predecessors, Tommaso Padoa-Schioppa, Italy's finance minister, is luck personified. Cash has rained into the treasury. In the first eight months of 2007, income- and corporate-tax receipts rose by 21%. The government says this is thanks to its clampdown on tax evasion. It reckons that €270 billion ($370 billion), or a fifth of GDP, was going unpaid each year (95% of Italians claim to earn less than €40,000).

Thwarted evasion, however, accounts for less than half the revenue increase. Another factor is that the economy is enjoying a rare spurt of growth: GDP is expected to rise by 2% this year. The opposition prefers to stress that Italians now pay more taxes at higher rates. Mr Padoa-Schioppa's first budget raised the top income-tax bracket to 43%. For those who pay their due, Italy is now an onerous place. What is more, taxpayers get miserable value for money. Public spending in Italy is higher than in Germany, if lower than in France (see chart). But the clincher is that public-sector pay is high and the quality of public services is among the worst in Europe.

That imbalance fuels growing impatience with the politicians. On September 8th Beppe Grillo, a comedian, set out to gather signatures for a petition calling for changes to the electoral and parliamentary rules. He hoped for 50,000 signatures, but got six times as many. Umberto Bossi, leader of the Northern League, recently proposed a tax strike. He has since back-tracked to propose a boycott of state-run lotteries, but not before winning the support of a respected employers' representative for his more radical idea.

That was a sign of exasperation in business, notably in the north. The employers' leader, Luca Cordero di Montezemolo, has called the high level of corporate tax an “emergency” and urged the government to trim it. Yet the left-wing parties in Romano Prodi's coalition want any extra revenues used to mitigate social inequality.

Caught between these demands, Mr Padoa-Schioppa feels anything but fortunate. His reaction is to remind people that Italy has vast debt; that the interest soaks up cash that could be spent on infrastructure and welfare; and that the tax bonanza has done little more than smooth progress towards the aim of cutting debt to below 100% of GDP by 2010. This point is the more pertinent since there are signs that the economy is losing puff. It grew by only 0.1% in the second quarter.

Mr Padoa-Schioppa has so far resisted calls for tax cuts and argued that, far from raising spending, the government should cut it. He has circulated a “green book” to ministers with tips on how to curb their departments' spending. So far, he has been backed by Mr Prodi. But, with many on the right of the coalition calling for tax cuts, and the government appearing to be more unpopular than ever in the polls, the pressure to give way is growing.

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The Romanian Orthodox Church

Crowned with thorns

Sep 13th 2007 | BUCHAREST
From The Economist print edition

The church elects a new patriarch, but still has to confront a tainted past

IN ROMANIAN politics, smears and scandals are commonplace. This week's vote for a new head of the Romanian Orthodox Church was similar. Though most public institutions are seen as corrupt and ineffective, the church enjoys high public trust. Nearly 90% of Romania's 22m people adhere to it, and its $4 billion fortune makes it the country's sixth-biggest enterprise. Yet the church is controversial. Over-zealous exorcisms have proved dangerous: a nun died in one in eastern Romania in 2005. Some church leaders who are suspicious of ecumenical dialogue with minority religions have links with nationalists. Worse, the church will not look into its communist-era past, when it was a loyal servant of Nicolae Ceausescu.

The only senior cleric to speak publicly on this, Bishop Corneanu, recalls weekly meetings with the Securitate secret police. But the late patriarch, Teoctist, resisted the opening of secret-police files on the clergy. Mircea Dinescu, of the investigative body analysing the Securitate Archives (CNSAS), says 16 files on high-ranking clergymen were burnt in the 1989 revolution. Neither Metropolitan Daniel (who was elected to replace Teoctist on September 12th) nor his rival Bartholomew admits to links with the Securitate. Yet both travelled abroad when this was all but impossible for those who did not co-operate with the regime. Mr Dinescu has said several senior clergy are proven collaborators, but he was holding fire for now. “We decided to let them run, not that they should think we want to undermine their destiny. We will decide after the election.”

This highlights how Romania's secret-police files are a political currency. The CNSAS is seen by many as a politicised institution. Metropolitan Bartholomew, an 86-year-old who once belonged to a fascist youth movement and was jailed in 1958-64, calls Mr Dinescu's approach “unpardonable interference in the internal affairs of the church”. Yet some find it puzzling that he was later sent to America for nine years. Metropolitan Daniel, who is 56, studied and taught theology abroad, including at an ecumenical institute in Switzerland.

His ecumenical views were attacked in the campaign. Fly-posters in Bucharest read: “We don't want a patriarch who used to be employed by the Catholics and is backed by the Masons.” Though his liberal stance won the electoral college, Patriarch Daniel will still have much to do to shore up his church against its critics.

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Charlemagne

Enter, pursued by a bear

Sep 13th 2007
From The Economist print edition

Illustration by Peter Schrank

At last the European Union as a group is getting tougher with Russia

MOST people attacked by bears bring it upon themselves, rugged country types tell you. These fierce creatures should be treated with respect. Should a bear wander near your backyard, you should restrain small, reckless members of the household who may foolishly provoke it and then run to your arms when it growls, leading the enraged animal straight to you.

For too long, many European Union leaders have taken a similar view over dealing with Russia, Europe's backyard grizzly. Countries that crossed Vladimir Putin's Russia, especially the small (eg, the Baltics) or reckless (eg, the Poles) have found themselves chided for provoking a “strategic partner”. Instead of the comforting embrace of EU solidarity, the targets of Russian growling have often been asked to face their fate alone, rather than allow bilateral disputes to “hijack” the EU's entire relationship with the rising energy superpower.

Encouraged by its ability to divide Europe, Russia has expanded its bilateral disputes. The original list was dominated by ex-Soviet satellites (rows over Polish meat exports, Lithuanian oil imports, the siting of an Estonian war memorial, and Czech and Polish plans to host an American anti-missile defence system). But Russia is now growling at old Europe, too. Ask Sweden and Italy (trade squabbles), Spain (a Russian spying scandal), and Britain, locked in the fallout from the radioactive poisoning in London of Alexander Litvinenko.

At last, the EU is reacting as a group. At the “informal” meeting of EU foreign ministers in northern Portugal on September 7th and 8th, a closed-door discussion on Russia turned into a remarkable round of soul-searching. “The tone of the discussions today was very different from anything I've ever encountered,” said one veteran. “We were all saying the same thing: this is a very different Russia.” Europe has officially sought a “strategic partnership” with Russia since 1999, when the phrase was coined in an EU policy paper. But this quest has failed, the minister said bluntly. Such a conclusion was not really driven by a shift in European thinking, he added, but by the reality of Russia's recent behaviour.

Private fretting about Russia is nothing new. But this time the fretting continued in public, as ministers emerged from deliberations in Viana do Castelo (the political fief of their host, the Portuguese foreign minister, Luís Amado). Mr Amado, whose government has sought warm ties with Mr Putin, pointedly called for a “true strategic partnership” with Russia, saying that such a partnership should not include the “problems” that the EU had recently encountered. The external-relations commissioner, Benita Ferrero-Waldner, raised the “paradox” that EU-Russia trade and investment flows were growing by 20% a year, but “we also have increasing questions about Russia's commitment to democracy and human rights and the rule of law.”

Even the familiar rhetoric about speaking with a single voice seemed more purposeful, with unity presented as a defensive strategy (in contrast with woolly past talk of preserving EU credibility). Bernard Kouchner, the French foreign minister, noted that, when the EU was weak, Russia was ready to talk to it; but, when it was strong, the Russians talked to member countries “one by one”. Mr Kouchner's boss, President Nicolas Sarkozy, last month accused Russia of using its power with some “brutality”. This is a huge change in tone from his predecessor, Jacques Chirac, who treated Mr Putin as an ally and chum.

Indeed, it is hard to overstate the importance of new leaders in France and Germany. The German chancellor, Angela Merkel (who grew up under Soviet occupation in East Germany), has challenged Mr Putin in public, chiding him earlier this year about the clumsy suppression of opposition protests. In case anyone had forgotten how different she is from her predecessor, Gerhard Schröder, he popped up in Moscow recently to urge the EU to overrule Poland, which is blocking talks on a new EU-Russia treaty because of the meat ban. Sometimes, it is in Europe's interest to “forget about the interests of individual countries”, explained Mr Schröder, now pursuing his individual interests as chairman of Nord Stream, a German-Russian pipeline company.

Even outside the EU structure, diplomats hail a new “rigour” in European thinking about Russia. A senior NATO official talks of Russia “overplaying” its hand, and picking fights on strategic issues that touch European nerves. “If the Russians misplayed it anywhere in the last four months, deciding they didn't need the Conventional Forces in Europe Treaty was fundamental.”

Not divided, but not united either

None of this means Europe is wholly united against Russia. At the meeting in Portugal, Poland's foreign minister, Anna Fotyga, reportedly asked if the time had come to abandon the quest for a strategic partnership with Russia, but this idea was unanimously rejected. The EU cannot ignore Russia as a neighbour or trade partner (it supplies about half the EU's gas imports), nor can it deny Russia a role as actor in world trouble spots from Iran to North Korea, the Middle East and Kosovo.

But can some EU members continue to treat Russia as a benevolent ally? That is a new question. Take Kosovo. For a variety of reasons, several members (including Spain, Greece, Slovakia and Romania) dislike the idea that Kosovo may soon declare unilateral independence from Serbia. Their insistence on deciding the Kosovo question in the United Nations Security Council amounts to giving Russia a veto over Kosovo, giving it in effect a say over EU policy.

But that is now becoming harder to stomach. In Portugal, several ministers said they were unhappy about a breakaway by Kosovo—but hated still more letting Russia dictate policy in the neighbourhood. Another moral from bear country suggests itself. Once a rogue bear is on the prowl, it is not just foolish to provoke it. It can be equally rash to lie down and try to appease it.

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Labour and the unions

Down tools, lads

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From The Economist print edition

Getty Images

Unions threaten an autumn of strikes. That could work to Mr Brown's advantage

Gordon Brown

MARGARET THATCHER, Britain's most famous union-buster, seems an odd heroine for the leader of a party whose roots lie with organised labour. Nevertheless, on September 3rd Gordon Brown confessed to admiring the Iron Lady as a “conviction politician” who saw “the need for change”. Lady Thatcher was, her spokesman said, flattered by the prime minister's praise (see article).

Such comments will have been well received by their target audience of wealthy, middle-class voters, but they will hardly have endeared Mr Brown to Labour's more traditional supporters. On September 10th he addressed the most traditional of all when he gave his first speech as prime minister to Britain's annual conference of trade unions.

Relations between Mr Brown and the unions are strained. As chancellor, he was the architect of many policies that they find hard to stomach, most notably his enthusiasm for the Private Finance Initiative, under which private firms build and run public infrastructure such as hospitals and schools. But the immediate flash point is over pay. Unions are unhappy with Mr Brown's spending plans, which limit many public-sector workers to pay increases that are lower than inflation.

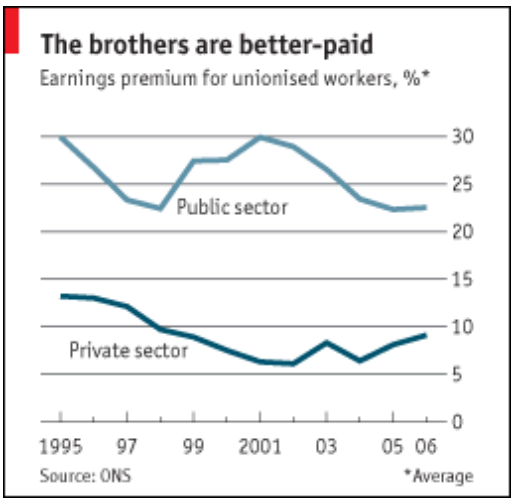
Mr Brown's speech did nothing to defuse the row. The talk was of prudence and the need to hold down pay so as not to stoke inflation. His reception was stony, and many unions are now talking of large, co-ordinated strikes across the public sector. Officials representing local-government workers, prison officers (who staged a day-long illegal strike last month), National Health Service staff and teachers all backed a call for walkouts in the coming months. Unison and the Public and Commercial Services (PCS) Union, two of the biggest public-sector unions, announced formal plans to ballot their members. Journalists, politicians and union men talk excitedly of an “autumn of discontent”.

That, at least, is just rhetoric. The “winter of discontent”, in 1978-79, saw a series of massive strikes by everyone from lorry drivers to mortuary workers that left petrol stations empty, rubbish piled up in the streets and, in Liverpool, dead bodies unburied. Today's unions are a shadow of those that humiliated James Callaghan's government. A decade of steady economic growth, says Alex Bryson, research director at the Policy Studies Institute, has eroded the premium that unionised workers earn over their unorganised brethren (see chart). Membership has fallen from 13.2m in 1979 to about 7.6m in 2005. Nearly half of today's workforce has never been part of any trade union.

Yet the raw numbers overstate the decline of the unions' influence. They remain strong in the public sector, where almost 60% of workers are unionised (in the private sector, only 17% are). Many

Infographics

of the more heavily unionised occupations, such as teaching or railway work, can cause considerable disruption if workers down tools. Londoners can attest to this: chaos ensues when industrial action suspends the Tube, as happened earlier in the month. Much has been made in the past few years of the so-called “awkward squad,” a group of union bosses including Mark Serwotka, the boss of the PCS, or Bob Crow, who heads the RMT, a transport union, who cultivate a more militant image than their cuddlier predecessors.



Rows over party funding have also increased their power. Under Tony Blair, the Labour Party courted businessmen, who responded by showering it with money. But the cash-for-honours scandal has scared many donors away, restoring the unions—at least temporarily—to their traditional role as the party's main paymaster. And some of the unions' concerns could resonate with the wider public. They criticise the telephone-number bonuses paid to City slickers, for example, and the success of the super-rich in avoiding the attentions of the taxman. And they are pressing the prime minister to hold a referendum on the new EU constitutional treaty, which he has conspicuously refused to promise.

Despite all this, Mr Brown is in a fairly strong position. For all his keenness on private participation in the public sector, he has a better reputation among trade unions than did his predecessor. An autumn of strikes would risk alienating Mr Brown just months into his premiership. Perhaps with that in mind, the Trades Union Congress, an umbrella outfit that organised the conference at which Mr Brown was speaking, tried to play down the row. It praised the prime minister's union-friendly policies on unemployment and training, and argued that he “shares many of our values and objectives”.

From Mr Brown's point of view, a quarrel with the unions may be useful, provided it does not get out of hand. Like his praise for Mrs Thatcher, it would help Labour reassure right-leaning voters that it can still be trusted with the economy. And although the unions may be unhappy with many of Labour's policies, there is no obvious rival to whom they could pledge allegiance. “Any union that was thinking seriously about disaffiliating would have already done it,” says Richard Hyman, an industrial-relations expert at the London School of Economics. “If they could stomach ten years of Tony Blair, Gordon Brown is hardly likely to tip the balance.”

As for the strikes, they may happen, but precedent suggests a deal will be cut. It happened in 2005, when a summer of strikes was threatened by local-government workers over changes to their pensions. Earlier this year ministers offered a new pay deal to nurses after they talked of striking. Expect much huffing and puffing, followed by an anticlimactic fudge.

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NHS audit

Big spender, unwise spender

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From The Economist print edition

So that's the way the money went

Get article background

THOSE in power control the future by controlling the past, wrote George Orwell. In a clever twist, Gordon Brown has adopted the opposite technique. Both as chancellor of the exchequer and as prime minister, he has sought to colonise the future rather than the past in order to hold sway over the present.

The most influential of the forward-looking inquiries that he commissioned at the Treasury set out a 20-year vision of the money needed to turn the publicly financed NHS into a really good health service. A report by Derek Wanless, a former banker, recommended in the first instance a hefty five-year boost in its resources. Mr Brown approved the proposal in 2002, sanctioning annual rises in the NHS budget of 10% in cash, worth over 7% in real terms, until 2007-08.

Since that cash infusion is now in its final year, an examination of how the money has been spent and what it has achieved might seem an obvious starting point for any new policies. Not a bit of it. Instead, one of Mr Brown's first decisions at Number 10 was to ask Lord Darzi, a junior health minister, to work out the way ahead for the NHS over the next decade. Awkwardly for Mr Brown, however, the King's Fund, a health-policy think-tank, had the bright idea of getting Sir Derek to take another look at the NHS, this time casting back rather than forward. His audit makes uncomfortable reading for the prime minister.

Only diehard opponents of the NHS would dispute that there have been genuine advances in the past few years. Patients needing operations such as cataract removals no longer have to wait for ages. Many more doctors and nurses now work in the health service. Hospitals have been able to buy expensive new kit such as MRI scanners. Family doctors are prescribing more cholesterol-lowering statins that reduce the risk of heart attacks and strokes.

Given the big sums of extra money that the NHS has received, however, it would have been extraordinary if the health service had not got better. The question that matters is whether it has improved enough. Sir Derek's answer is that the taxpayer has got poor value for money.

The danger in throwing a lot of cash at the NHS was that much of it would be soaked up in higher costs rather than producing more health care. That is precisely what has happened. The report finds that 43% of the extra money given to the NHS since 2002 has gone into higher pay and prices. According to John Appleby, an economist at the King's Fund who worked on the review, rising earnings are responsible for around 90% of these higher costs. New contracts have placed Britain's doctors among the best-paid in the world, and given nurses and other NHS staff a healthy boost in their earnings.

One of the aims of the new contracts was to raise productivity. Sir Derek finds scant evidence of any such payoff, however. Rising unit costs betray a failure to make the efficiency gains that he had banked on when setting out his plan to regenerate the NHS.

Smarter use of information technology could help to raise productivity as well as make patient care safer. But the government's big push to introduce electronic patient records has been dogged by delays. Sir Derek's worries about the future of a programme expected to cost £12.4 billion ($25.2 billion) in the ten years to 2013 are widely shared. On September 13th MPs on the health committee of the House of Commons highlighted “a worrying lack of progress on implementing local systems”.

From April 2008 the real annual growth in NHS funding is expected to halve. The financial clamp-down may not be such a bad thing. The lesson of the past few years is that money alone will not cure the NHS. In its 1997 manifesto Labour promised to be “wise spenders, not big spenders”. The pity is that in government it forgot that pledge, at such expense to the taxpayer.

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Defence sales

Teachings of the insurgents

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How barefoot soldiers are changing Britain's defence industry

EMERGING from a bunker and leaping on to a long-range patrol vehicle, Captain Dick Taylor shouts out orders to his men. One quickly sets up a gizmo to detect incoming mortar fire, another deploys a light-radar system to spot infiltrators. Captain Taylor's mission has little to do with toppling nasty regimes or safeguarding democracy. His job is to display British defence equipment to best advantage in a cavernous hall housing one of the world's largest arms shows. It opened in London on September 11th.

The sight of military officers from scores of nations scuffing their dress shoes while clambering on to tanks and peering through gun sights gives the show the air of a village fair, but this is no Glastonbury with guns. Serious business is being done here as Britain's arms industry, led by BAE Systems, its biggest defence firm by far, displays its wares.

Amid the glossy stands highlighting Britain's prowess, however, ignominy also awaits. For the country that invented tanks and led the world in their development through the 1970s (when it discovered a revolutionary sort of armour) may soon be ferrying its soldiers to battle in cars designed and built by its main competitors in the defence market: America's General Dynamics, France's Nexter (formerly Giat) and Artec, a Dutch and German firm. A vehicle proposed by BAE was dropped from the procurement contest in June.

The spoils for the winner of this competition are rich. Britain plans to splash out on more than 3,000 armoured cars and light tanks under its FRES (Future Rapid Effects System) programme, spending as much as £16 billion ($32.5 billion) buying the vehicles and another £50 billion or so maintaining and updating them. It is not only Britain's biggest purchase of armoured vehicles since the second world war but also the biggest such deal outside America. And whichever vehicle wins the contract will likely fare well in other export markets too. “The choice of the British army will be seen by all abroad,” says Nexter's François Monira.

Critics fret that this shows how Britain's defence industry is fading. Their conclusion may be premature. The main reason why Britain has no plausible armoured-car candidate of its own is that, until recently, the army thought the sort it now plans to buy was no longer needed. It was seduced by the appeal of new technologies for detecting foes and linking friendly forces in “network-centric” fighting. This would let light vehicles in future replace the heavy tanks of today.

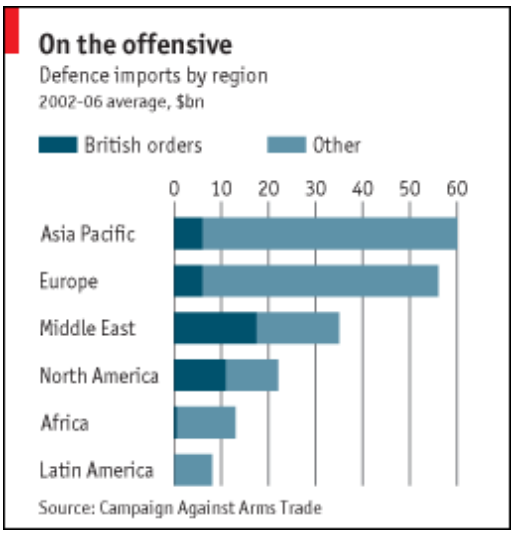
But the army's experience in Iraq and Afghanistan has made such ideas seem fanciful. Insurgents there have proved adept at blowing up lightly armoured vehicles (and some bigger ones too) using makeshift bombs and hand-held rockets. This has brought thick steel back into fashion for the main fighting forces and has also created a market for tens of thousands of patrol vehicles that are specifically designed to resist mines, bombs and rockets.

That Britain, these days, is not particularly good at making either sort of armoured car matters little. The country has long been the world's second-largest exporter of defence equipment (though it was recently eclipsed by Russia, which happily sells to countries that Britain shuns). It has managed this by focusing mainly on two regions (see chart): North America, where it accounts for almost half of all imports, and Saudi Arabia, which is expected to sign a new contract soon for at least £20 billion-worth of British-assembled Eurofighter jets.

Infographics

Re-inventing armoured cars may play to national pride but it makes little economic sense. Instead, British firms are trying to make the computers that will link them up. Sensible, perhaps, but

it does risk repeating the mistake Britain's shipyards made: designing products so sophisticated that they are likely to be bought only by the richest navies, most of which have yet to overcome their own national pride.



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The McCann case

The plot thickens

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From The Economist print edition

The latest developments in the disappearance of a three-year-old

THERE is not much that fascinates the great British public more than a juicy “whodunnit”, especially where the victim is a beautiful blonde child. Photographs of little Madeleine McCann have scarcely left the front pages of the British press since she disappeared on May 3rd from the holiday apartment rented by her parents in Portugal's Algarve. Her distraught parents, both doctors, won praise for their energetic and dignified campaign to keep their daughter in the public eye in the hope that she would soon be found.

But three months later, in an extraordinary twist, Kate and Gerry McCann have become the main suspects in what appears to be developing into a murder inquiry. Nothing has yet been made explicit. And so far, the couple remain simply “*arguidos*”, or formal suspects. Yet the Portuguese press has been stuffed with speculation and tip-offs from anonymous police sources.

While gleefully repeating it all the next day, the British media has been scathing about almost every aspect of the Portuguese system, from its supposedly bungling police to the vagaries of its criminal code. Some of the criticism, such as the failure to seal the crime scene promptly, seems justified. But other complaints, including the police's failure to keep Madeleine's parents and the press sufficiently informed, appear to arise from a misunderstanding of the differences between Britain's common-law system and Portugal's quite distinct civil-law tradition.

In Britain, details of an investigation can be reported usually until someone is charged. Thereafter, a virtual gag is imposed on the press until the case comes to trial. In Portugal, it is the other way round. Nothing about a criminal investigation is supposed to be reported until charges are brought (though leaks ensured acres of coverage in the Portuguese press). This is a two-step procedure, starting with the naming of official suspects, which requires relatively little evidence, before progressing to a formal indictment if more conclusively damning evidence is found.

In the McCanns' case, this stage has not yet been reached. A 1,000-page dossier has been handed by the prosecutor supervising the case to a judge, not to ask whether charges should be brought—the prosecutor takes that decision—but rather to ask for his permission either to make an arrest (Kate McCann appears to be the main suspect), or to carry out some special procedure.

The McCanns, now back in England, have promised to return to Portugal if they are wanted for further questioning. They might have other ideas if they are actually faced with arrest and prison. But Portugal could issue a European arrest warrant—a fast-track extradition process requiring no hard evidence of guilt. Although the couple could contest it, legal experts think it unlikely they would succeed. Whatever now happens, Madeleine will not yet fade from public view.

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London's mega-mosque

The crescent and the very cross

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From The Economist print edition

Why plans for a giant new mosque have upset Christians—and Muslims

Infographics

Megaflocks

Largest religious venues

Denomination	Location	Capacity
Islam	*Abbeymills mosque, West Ham, London**	*12,000*
	Baitul Futuh mosque, Morden, Surrey	10,000
Independent Christian	Kingsway ICC, Hackney, London	4,000
Sikh	Sri Guru Singh Sabha Gurdwara, Southall, Middlesex	3,000
Church of England	St Paul's Cathedral, Central London	2,500
Roman Catholic	Metropolitan Cathedral of Christ the King, Liverpool	2,500
Jehovah's Witnesses	East of the Pennines Assembly Hall, Rotherham, South Yorkshire	2,100
Jewish	Edgware United Synagogue, Middlesex	1,500
Hindu	Shri Venkateswara Temple, Tividale, West Midlands	1,200
Scientology	St Hill Manor, East Grinstead, West Sussex	1,000
Buddhist	Rigpa, Central London	230

Source: Respective organisations *Not yet built

A FEAST of religiously-inspired architecture awaits visitors to Britain. Lovers can swap sweet nothings in the "whispering gallery" of St Paul's Cathedral. Among the ruins of Kirkstall Abbey, actors perform Shakespeare *al fresco.* Most postcards sent home from Cambridge feature the colossal gothic chapel of King's College, the unofficial symbol of the university.

These mighty Christian edifices are increasingly eclipsed by the buildings of less familiar faiths (see chart). The Shri Venkateswara Hindu temple in the West Midlands claims to be Europe's largest, and Surrey's towering Baitul Futuh mosque makes a similar boast within Islam. In west London Sri Guru Singh Sabha says it is the biggest Sikh *gurdwara* outside India. Even the largest Christian churches are now independent outfits that have nothing to do with the Church of England.

Despite such diversity, plans for a huge new mosque in Newham, east London, have raised an unholy fuss. The Abbeymills mosque would hold 12,000 worshippers and a school, making it Britain's largest religious building and almost five times the size of St Paul's. If it is built, as planned, next to the Olympic park, the mosque would greet the world when it arrives in 2012. London's multicultural mayor, Ken Livingstone, is in raptures; less happy are the 281,685 who signed a petition calling for the "mega-mosque" to be banned. A formal planning request is due next year, and the final say is likely to be with the communities secretary, Hazel Blears.

Some cry favouritism. Just as architects' drawings of the mosque emerged, Britain's largest church, the Kingsway International Christian Centre in nearby Hackney, was told it would have to make way for the Olympic village. This week the church packed its bags for an uncertain future (though a fat compensatory cheque is in the post). Opposition has also come from some local Muslims, 2,500 of whom signed a petition against the mosque—probably because of the ethnic and theological rivalries among Newham's south Asian, Arab and African residents.

As with anything involving Muslims these days, the matter is also seen through the prism of terrorism. In 2003 police raided London's big Finsbury Park mosque, and found weapons and fake passports. One of its preachers, Abu Hamza, was later jailed for inciting murder and racial hatred. Some suggest that Abbeymills could be used in the same way. In reality, skulduggery is probably easier to monitor in a mega-mosque than in a backstreet outfit. But someone in the police is worried: a police report on extremism in mosques found its way into the *Times* on September 7th—oddly, the day of the first public

meeting on the Abbeymills project.

Attention has focused on Tablighi Jamaat, the 80-year-old Muslim movement that proposed the mosque and says it can raise the £70m or so needed to build it. Most do not consider the group extremist. “While in the movement they are not supposed to have any political activity,” says Marc Gaborieau of the Centre National de la Recherche Scientifique in Paris—though he adds that some dissatisfied followers go on to more politicised groups.

Alan Craig, the Newham councillor who has led opposition to the mosque, plays down fears of terrorism but criticises the group's “them and us” attitude. “If a Christian church was preaching the same thing [isolationism], I would be against that too,” he says. One local Muslim organiser agrees. “They're not radical at all. It's impossible to get them to vote, become school governors, or anything.” There is endless panic about political Islam. Is apolitical Islam much better?

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Religious schools

Holy alliance

Sep 13th 2007
From The Economist print edition

More state funding is headed their way

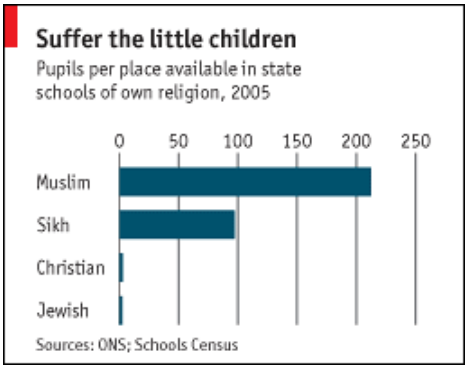
“GIVE me the child until he is seven, and I will show you the man.” This Jesuit saying both attracts and frightens many religious folk. The idea of influencing the life of a nation by running its schools is attractive. Infuriating secularists by hinting that proselytising is the real purpose of those schools, however, is scary.

But the secularists' star is on the wane. On September 10th the Department for Children, Schools and Families, together with 15 religious groups, published a quasi-official vision of the future role of religious organisations in running schools. A bigger role and in more schools, was its central thrust. Around 100 independent Muslim schools are to be helped to join the seven already in the state sector, and the Church of England's ambition to add an extra 100 state secondaries to its current 200 or so is endorsed. Nor will new religious schools have to reserve places for those of other religions, or of none; the government tried to insist on this in 2006 but backed down in the face of opposition, mainly from the Roman Catholic church.

The state came late to education in England. It was not until 1870 that local school boards began to be set up to provide primary education for all. By then the established Anglican church had opened many thousands of schools to cater for the poor, and the Catholic church had been offering education since the mid-1800s. Most schools run by both churches eventually came into the state sector, accepting public money in return for giving up some freedom over what they taught. The result is that 6,250 of the 17,500 state primary schools in England and Wales, and 600 of the 3,400 state secondaries, are run by religious bodies. Most of them are Anglican or Roman Catholic; 37 are Jewish.

Should their parents desire it, Christian and Jewish children can usually find a place in a school run by co-religionists (see chart). Most of those from other religions must pay for the privilege, however, even though there are ten times as many Muslim school-aged children as Jewish, for example. Demands for a wider range of state-funded religious schools found a willing listener in the previous prime minister, Tony Blair. Since 1997 seven Muslim, one Seventh Day Adventist, one Greek Orthodox and two Sikh schools have joined the state sector, and a Hindu primary school will do so in 2008.

To some, this is a recipe for disaster. Sorting children by religion leads to segregation, if not extremism, they say, and Muslim schools in particular risk fuelling dangerous fires. The current situation is unfair to those who are neither Christian nor Jewish, but this argues for taking away the privileges of existing religious schools, not opening more of them.



Supporters reply that many religious schools are ethnically mixed: Roman Catholic schools see Irish, Filipino and Polish children rubbing shoulders, and many Anglicans are black. More surprisingly, some such schools are religiously mixed too. If places are not filled by those of the appropriate religion, they must be offered to anyone else who wants them, and some, particularly Catholic girls' schools, are popular with Muslim families.

The government claims to be following parents' wishes in opening more religious schools: they tend to be popular and often have good exam results. Yet a study in 2006 by researchers at the London School of Economics showed that this apparent success was due to the social characteristics of the children they admitted, rather than to superior teaching or ethos. That points to a more potent cause of segregation than opening a handful of new state Muslim schools: if Christians (or those who can put up a decent pretence) don't like what they see in a local secular school, they can abandon it to others, fostering in effect an ethnic ghetto. Segregation is a game it takes two to play.

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The Tories on the environment

A greener shade of blue

Sep 13th 2007
From The Economist print edition

Conservatives grasp for ever more eco-friendly ideas

David Cameron

IT IS hard to recall that the environment was a fairly marginal issue in British politics until a few years ago. Its arrival in the mainstream was cemented in December 2005 when the Conservative Party, not an outfit renowned for its environmental credentials, took up the cause. David Cameron, its new leader, made several speeches on the topic, paid a now-iconic visit to a melting glacier in Norway and stuck a windmill on his roof.

But greenery presents Mr Cameron with a dilemma. As all the big parties now assert their eco-worthiness, the Tories can distinguish themselves only by offering more radical policies than the rest. Yet any move in this direction risks alienating a party base already unhappy about Mr Cameron's refusal to back grammar schools and promise tax cuts, both classical Tory commitments.

A group set up by Mr Cameron to suggest policies on the issue was scheduled to report on September 13th, but ideas trailed by the men who headed it, John Gummer, a former environment secretary, and Zac Goldsmith, editor of the *Ecologist* and a parliamentary candidate, aroused hostility among the party faithful in advance. Conservative Home, a grassroots website which has the ear of the party elite, gave warning that the proposed burden of green taxation and regulation could mean “unilateral economic disarmament” for Britain. Simon Wolfson, the boss of Next, a retail chain, and a donor to Mr Cameron's leadership campaign, was also critical.

The Tory leader has had enough practice at handling his policy groups—this one is the last of six to report—to put clear water between himself and controversial ideas. He has already sounded cool about two of the report's proposals: allowing local authorities to make out-of-town supermarkets charge for parking there, and a moratorium on airport expansion.

But if he is to avoid the charge that his environmentalism is merely symbolic, Mr Cameron will have to adopt some of the group's more substantial recommendations, which include a new tax on short-haul flights. Indeed, the report abounds with ideas for green taxes: a hike in the landfill tax on business, for example, and incentives for homeowners to add energy-saving features to their properties.

Green taxes are not much more popular among the wider electorate than among the Tory faithful, however. Polls have shown that almost two-thirds of voters believe politicians use them to raise revenue rather than to fight climate change. And the Tory pledge to offset new green taxes with tax cuts elsewhere is not foolproof. Maurice Fitzpatrick, a tax expert at Grant Thornton, an accountancy firm, says the Tory position is “reasonably credible” but doesn't dismiss the risk that, if taxes change behaviour, there will be less polluting activity to raise revenue from.

Andrew Leicester, of the Institute for Fiscal Studies, a think-tank, points out that the government has already been burned in this way. In 2001 employers' national-insurance contributions were cut to offset the introduction of the climate-change levy and a tax on digging up sand, gravel and rock. The revenue raised from the green levies was less than that lost through the cut in national-insurance.

Some Tory insiders thought the final report of the public-services policy group, published on September 4th, was lightweight. Few will say the same of the latest effort, which runs to 547 dense pages. Compiling it must have been tough: choosing which bits of it to make Tory policy, a task that ultimately will fall to Mr Cameron, will be tougher.

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Bagehot

The unquiet ghost

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Illustration by Steve O'Brien

How and why Margaret Thatcher continues to haunt and damage the Conservative Party

THE job interview that you arrive at naked; a teenage exam that is endlessly missed: everyone has events and crises that take root in the unconscious, to be replayed, warped but recognisable, in dreams. Countries, too, have their archetypes—people or events that embody national feelings and characteristics. In Britain they include Queen Victoria, Dunkirk, roast beef—and Margaret Thatcher. If Britons over the age of 30 meet a prime minister in their sleep, it is likely to be Lady Thatcher. With her unique combination, in post-war British history, of tectonic achievement and combustible personality, she is the leader from whom there is no escape; in comparison, ten-year Tony Blair merely grazed the national consciousness. This deep imaginative hold has been good for the country, and the Labour Party. But it continues to hobble her own Conservatives.

Last week, Michael Ancram, a one-time Tory bigwig, criticised some of his colleagues—read: David Cameron, the current leader—for “trashing our past [and] appearing ashamed of our history”—read: Lady Thatcher. Gordon Brown promptly compared himself to her: unlike Mr Cameron, he said, both he and she were “conviction politicians”. The claim furthered two campaigns that Mr Brown has waged since he became prime minister. One, to reverse a famous Thatcherite paraphrase, is to bring discord where harmony threatened to break out, in the Tory party. The other is to court Conservative voters through small but eye-catching reactionary moves such as reviewing the drug laws. Yet his bid to paint himself as a temperamental Thatcherite, like his other cross-dressing stunts, is only a tiny part of a much vaster political heist. Because, in fact, he is a Thatcherite.

Superficially, he and Lady Thatcher are oddly similar. Both are workaholics. Both emerged from ascetic low-church backgrounds with firm faith in good husbandry and industry, plus a Victorian notion of the deserving poor. Both are economic determinists. Beneath these superficial similarities, there are more similarities. Even if he uses different arguments to justify them, and absurd euphemisms to describe them, Mr Brown's economic policies are essentially Thatcherite. The overall tax burden has varied, and some wealth has been sneakily redistributed, but the fundamentals are the same: privatisation and a flexible labour market; lowish income tax (and high inequality); entrepreneurialism and property-ownership revered.

We are all Thatcherites now: the Conservatives have too often responded to Labour's seizure of their territory by flailing to the right. That convergence, and the intellectual squeeze it puts on the Tories, have become orthodoxies. But Lady Thatcher's legacy to the party she once led has been worse than merely confronting it with an adversary that, by emulating her, made itself electable. The trouble is, Mr Blair and Mr Brown understand her success better than many Tories do.

It wasn't only the economics that Labour learned from Lady Thatcher, humanising them with social liberalism: it was the theatrics too. When Mr Brown arrived at Number 10, vowing “change” more times than anyone could count, he was signalling a shift from the recent past. But he was also obeying a Thatcherite precept that Mr Blair followed too, albeit more in rhetoric than in reality: an idea of government as permanent revolution, thrusting change upon a recalcitrant but ultimately grateful nation. Revolutionaries, of course, need enemies: Lady Thatcher had communism, Argentina, the IRA, the unions and the Tory “Wets” (not necessarily in that order). If the enemies don't exist, they have to be invented: thus Mr Blair's spurious “forces of conservatism”. Revolutions need strong leaders. Only over Iraq—admittedly a big only—did Mr Blair test his leadership in the confrontational way Lady Thatcher often did. But seeming strong, at least, became and remains a Labour fetish.

Too many Tories, on the other hand, misread and misremember her reign. They see her three general-election victories as proof that power can be regained on a neo-Thatcherite ticket—when in fact her wins rested largely on her opponents' weakness and the very different state of the country. Because she thought the place was floundering, and said so, they say so too—but it isn't, and trading in anxiety no longer quite works.

More damaging still are the reverberations of the party's putsch against her in 1990. “Those blue eyes. Don't you just want to swim in them?” says an imaginary but plausible Tory MP in “The Line of Beauty”, a novel of the Thatcher era (which refers to her “clumsiness transmuted into power”, another description that might fit Mr Brown). The bitterness between Thatcher loyalists and her “assassins” was fierce and prolonged. Even when it receded, feuding and blood-letting somehow stuck as Tory habits, in which Lady Thatcher herself occasionally participated.

Saint Maggie

It is because of these misreadings and divisions over Lady Thatcher that Mr Cameron is now obliged to pull off a near-impossible trick: reassuring some in his party about his Thatcherite credentials while reassuring the public, for many of whom the 1980s have come to be associated with callousness and greed, that the Tories have outgrown her. That image is, of course, a simplified caricature. But then Lady Thatcher—already an “-ism” while she was still in office—is now entering the phase of myth, with all its distortions.

The myth is powerful outside Britain too, especially in the former eastern bloc and America. A clutch of would-be Republican presidential candidates—Rudy Giuliani is due next week—have crossed the pond to touch the hem of Lady Thatcher's robe, seeing in her a living relic of what they now regard as a halcyon era of robust and not incompetent Anglo-American conservatism. For her own party, though, Lady Thatcher is less a useful saint than an unquiet, disruptive ghost.

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Terrorism

Visions of Osama bin Laden

Sep 13th 2007 | ALGIERS, BERLIN AND LONDON
From The Economist print edition

Al-Qaeda's leader returns and foresees victory in Iraq

Get article background

LIKE a seer of antiquity, Osama bin Laden has returned from the wilderness to cast his curse against the evildoers. America, he predicts, will fail in Iraq just as the Soviet Union did in Afghanistan. Capitalism and democracy are the worst form of “polytheism”, causing war, global warming, poverty and costly mortgages.

The solution to such wickedness, says al-Qaeda's leader, is for Americans to “embrace Islam”. Then war would end and Americans would be richer, because Islam (he claims) has no income taxes except the 2.5% tithe known as *zakat*. The call to convert is no rhetorical flourish; Islamic jurisprudence requires that non-believers be given a chance before they are attacked.

These are mostly familiar themes, though intelligence analysts will search the sermon (and a second internet message) for clues about his intentions, whereabouts (thought to be Pakistan's border region) and state of health. Is it a sign of confidence that his beard is dyed and neatly trimmed, and that he has forsaken his camouflage jacket and gun?

Mr bin Laden's return to the public eye, ahead of the anniversary of the September 11th attacks, was his first video appearance since America's 2004 presidential election. It coincides with a resurgence of his movement. Despite six years of America's “war on terror”, and in part because of its blunders, al-Qaeda and its offshoots have regrouped, replaced lost commanders and built up a stronger following around the world. Two large bombings in Algeria earlier this month (one of which killed more than 20 people in a crowd waiting to see president Abdelaziz Bouteflika), and the arrest of three suspects believed to be plotting attacks on American targets in Germany and perhaps Frankfurt's airport, are just the latest reminders of violent jihadism inspired, if not directed, by al-Qaeda.

Experts debate whether al-Qaeda is as dangerous, or more so, as in 2001. America's latest National Intelligence Estimate says al-Qaeda has “protected or regenerated” much of its ability to attack the American homeland. After the loss of Afghanistan, it has recreated a safe haven in Pakistan's lawless tribal belt, alongside its strengthened Taliban allies. Above all, it says, Iraq, where al-Qaeda is most active, serves to “energise the broader Sunni extremist community, raise resources and to recruit and indoctrinate operatives, including for Homeland attacks.”

British intelligence agencies, which once thought that al-Qaeda had been so broken up that little was left but its brand name, have also revised their view. Most of the actual or attempted attacks in Britain appear to have direct links back to al-Qaeda leaders in Pakistan. Other European governments are

alarmed by the rebranding of Algeria's Salafist Group for Preaching and Combat (known by its French initials GSPC) as al-Qaeda's branch in the Maghreb. It has so far concentrated on attacking symbols of the Algerian state and foreign workers. If it exploits links to the large North African diaspora in Europe, targets there may be next.

Al-Qaeda's ideology, if not the movement itself, has become more globalised. In Britain, those involved in plots include citizens of Pakistani origin, east Africans and Iraqis. Those behind the Madrid bombings of 2004 were of Moroccan extraction. Last year in Germany, two men of Lebanese origin planted bombs on commuter trains (they failed to explode). The latest arrests there were of a Turkish migrant and two German converts. The parents of their alleged leader, Fritz Gelowicz, are a businessman and a doctor. The three plotters are alleged to have trained in Pakistani camps run by the Islamic Jihad Union, an originally Uzbek-based outfit. The group later promised more attacks, and demanded that the German air force stop using a base at Termez in Uzbekistan.

The plot underlines concern about home-grown terrorism across Europe. Much of al-Qaeda's propaganda, as well as its military training manuals, are spread through a large network of jihadist websites. Muslims anywhere can become radicalised and join the fight, with little or no involvement from al-Qaeda's leaders. In Britain, and now in Germany, some converts to Islam appear to be particularly prone to extremism. The German Islam Archive, a think-tank and lobby group, estimates that some 4,000 people converted in the year to June 2005, more than ten times the annual average in the past decade; other experts question the figures.

Turks in Germany have until recently seemed disinclined to violent Islamism, in part because their community had close ties to the secular Turkish state. That may be changing. Markus Kaiser, a specialist with the intelligence service of Baden-Württemberg, says that Turkish-language jihadist material on the internet is growing markedly. Turks have joined the fight against Russia in Chechnya, and German-born veterans may now be helping to radicalise Muslims at home.

Though training is much easier abroad, such home-grown cells may need no direction from overseas and can act faster, making it harder to detect them. The German plotters were caught thanks to American electronic snooping which uncovered their e-mail exchanges with Pakistan. Future terrorists will learn from that.

Al-Qaeda has experienced some broader setbacks, however, notably in Saudi Arabia and Indonesia, where violent jihadist campaigns have been largely squashed. Palestinian leaders have tried to keep al-Qaeda away from their fight with Israel (though it has won followers in refugee camps in Lebanon and maybe Gaza). Still, Iraq is stoking the cause. Osama bin Laden says George Bush, by prolonging the war in Iraq, is repeating the errors of Leonid Brezhnev's Soviet Union in Afghanistan. And Western spooks fear that, like Afghanistan after the Soviet defeat, Iraq too will start exporting hardened terrorists.

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Boycotting Israel

New pariah on the block

Sep 13th 2007 | JERUSALEM
From The Economist print edition

The campaign for sanctions against Israel is growing. But it faces resistance and is less effective than it looks

FOR once, Israel's critics and cheerleaders agree on something: the Jewish state risks greater international isolation. Pro-Israel groups such as NGO Monitor and the Jerusalem Centre for Public Affairs say a new assault is on the way. In the other camp, Shir Hever of the Alternative Information Centre, an Israeli-Palestinian activist group in Jerusalem, says that advocating a boycott is no longer always treated as anti-Semitism. Both sides have a motive to exaggerate such claims. But “boycotts, divestments and sanctions” (known in the activist world as “BDS”) do seem to be growing.

AFP

Stop playing that tune

Pro-Israel lobbyists see this as part of what they call the “Durban strategy”, devised by activists at a United Nations anti-racism conference there in 2001, which marked a new high point for Israel-bashing. The real trigger, though, seems to have been a call two years ago by a coalition of Palestinian outfits to boycott products made in Israel or in its West Bank settlements, and to divest from (ie, sell shares in) Israeli firms, or foreign ones seen as profiting from Israel's occupation of the West Bank and (then) Gaza. Caterpillar, whose earth-movers are used for demolishing Palestinian homes and building on settlements, and Motorola, whose clients for communications equipment include the Israeli army, are popular targets.

This year two big British trade unions and the much smaller National Union of Journalists (NUJ) called on their members to boycott Israeli products. The Irish Congress of Trade Unions backed divestment. The public-sector union in the Canadian province of Ontario voted to support BDS last year; local activists are campaigning against Indigo, a retail chain that sells books and music. Its majority owners run a charity for Israeli veterans. In February an “Israeli Apartheid Week” was held on North American and British campuses for the third year running. Motions to boycott Israeli universities have passed at the conferences of two British teaching unions. A handful of American churches and the ecumenical World Council of Churches have considered divestment from companies like Caterpillar, as has the Church of England, Britain's established church.

Many more minor events—from a protest against Israeli products outside a German food store to the Dutch government's warning to a company that was helping to build the separation barrier in the West Bank—show how hostility to Israel, or at least to its treatment of the Palestinians, is finding expression.

Under closer inspection, the boycotts look flimsy. Most of the motions passed have been non-binding recommendations, or instructions to investigate the practicalities of BDS. Activists' votes at conferences may be slapped down by the membership, as with the NUJ's boycott, which was reversed after furious complaints from members. After pressure from Jewish groups, American Presbyterians, who voted in 2004 to look into divesting from up to five American firms, backed off last year without having removed a dollar. The two British teaching unions merged and voted anew to consider suspending links with Israeli institutions only to provoke a huge counter-attack by American college presidents.

All this recalls the haphazard campaign against South Africa before sanctions got UN backing in 1962. But the anti-Israel movement shows little sign of getting such official support. One reason for this is that Israel has more powerful lobbyists—both in Jewish organisations and in America's evangelical Christian movement, to whom the birth of the Jewish state is a fulfilment of prophecy (some BDS motions passed in American churches really reflect internal Christian rows). Unlike the African National Congress, which acted as both a moral beacon and an organiser for sanctions, the Palestinian leadership does not support BDS—fearing that it will hurt Palestinians as much as Israelis—and is much weaker and more divided.

The chief difference between the Israeli and South African cases is, however, in the moral sphere. Israel is a robust democracy with vibrant academic freedom. Whereas it was plain to most South Africans that “separate development” was a cover for a gross system of racism, the rights and wrongs in Palestine are both murkier and more fiercely contested. For all these reasons left-leaning diaspora Jews and campaigners against the occupation often argue against BDS and for more “constructive” engagement. Boycotting Israeli universities, they note, actually hurts some of the occupation's most trenchant critics (and may thus be unlikely to bother Israeli hawks).

Even fans of BDS do not fully agree on the best way forward. While some call for broad boycotts, others think “smart sanctions”, such as banning goods produced from settlements in the occupied territories, or from specific firms, will have more effect and sidestep claims of anti-Semitism. Israel's economy, they say, is more vulnerable to pressure than South Africa's—smaller, more globally connected and with fewer natural resources. “I don't think the boycotts will be as widespread as with South Africa,” says Mr Hever, “but a small and specific economic impact can change many people's minds.” Perhaps. But blaming Israel alone for the impasse in the occupied territories will continue to strike many outsiders as unfair.

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Media

Emerging journalism

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Journalism training is booming in the developing world

TRADITIONAL media may be declining in much of the rich world, but in poor countries it is booming. The growth in private media in developing countries has spurred much of the demand, as has new technology.

That is stoking journalism training in far-flung places, in many shapes and sizes. Joe Foote, an American professor, reckons there may be up to 3,000 courses. They range from full degree programmes to the short-term specialist training offered widely across Asia, Africa and Latin America. Groups offering such courses include the BBC World Service Trust, the Reuters and Thomson Foundations, the Institute for War and Peace Reporting (IWPR) and Internews Network, a media-development charity based in America. The Aga Khan, a tycoon-philanthropist and religious leader who has media businesses in the developing world, is considering starting a programme in Africa.

The trend took off after the collapse of communism, when former Soviet-block countries sought new journalists to replace the hacks of the state-controlled propaganda machines. Having started in Poland in the 1990s, the BBC trust has operated in over 50 countries, training more than 1,500 journalists in at least 15 languages.

These days the donors are particularly interested in niches, such as investigative reporting and science writing. But that approach sometimes flops. The need for basic reporting skills is still central. Trainers stress the need for flexibility. Kieran Cooke, a former foreign correspondent turned trainer, says course participants often just want to talk. “They have miserable salaries, take on considerable risks, and still want to carry on.”

Participants in the courses praise the results, while complaining about the lack of focus and co-ordination among some providers. Shapi Shacinda, the Reuters correspondent in Zambia and chairman of the press club in the capital, Lusaka, says that foreign-backed training in business and economic reporting has helped bring more sceptical coverage. Previously, news stories used to be taken straight from officials' statements, he says.

But governments are harder to teach. Encouraging students to probe sensitive topics may threaten their lives or livelihoods. An Iraqi journalist trained by and working with the IWPR was shot dead earlier this year. Just this week, Zambia's minister of information asserted that state-run media should not criticise the government. In Russia, an organisation founded by Internews has been closed by the authorities, who were apparently suspicious of its American backing.

Rich-country governments can be a problem too. Some try to influence the “messages” that trainers deliver, for example by insisting that their diplomats talk to classes on a regular basis. The big training groups insist that they control their own content. “We won't be paid to do messages,” says Anthony Borden of the IWPR. Blurring the boundaries can be dangerous both for journalists and the programmes that support them, he notes. But others may be less choosy.

More is not always better. Quality varies wildly. Places like Bangladesh and Rwanda have been showered with training in recent years. Gratitude is mixed with the wish for better co-ordination. David Okwemba of Kenya's *The Nation* newspaper, who also helps train journalists, bemoans overlap between courses and providers' failure to share information.

Some courses aspire loftily to build democratic societies through a free press. The BBC trust says it aims to give a say to the common man by holding institutions—public and private—to account. Such a range of goals makes measuring results difficult. Teaching how to point a camera or write a news story may be easy compared to raising awareness of broader issues such as HIV/AIDS.

Many old news hands scoff at the notion of formal journalism education. A well-stocked and inquiring mind plus sharp penmanship are the main assets, they reckon. But even the most grizzled veterans of rich-world journalism still seem glad to earn extra money tutoring tyros in poor countries.

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Magnets for money

Sep 13th 2007
From The Economist print edition

Illustration by Michelle Thompson

Financial centres are booming, despite predictions that new technology would spell their doom. But competition is getting keener, says Julie Sell (interviewed here)

THE late Middle Ages were a golden age for city-states. Merchant guilds created a network of them that dominated trading along the Baltic and North seas for centuries. Cities such as Lübeck, Hamburg and Bergen flourished in this early form of globalisation.

In time, the early 21st century may come to be seen as a golden era for a different sort of globalised city-state. Its protagonists are found in London's Mayfair, lower Manhattan and Hong Kong's central business district. Rather than loading ships, they spend their days (and many nights) in front of computer screens, moving zillions of dollars, pounds, euros and yen around the globe at the flick of a key.

Technology, some predicted, would end this sort of clustering in city centres. Why would financiers want to live and work in pricey, jam-packed urban jungles? Armed with broadband, mobile phones and BlackBerries, they could work from almost anywhere. Yet as this summer's market turmoil showed, a BlackBerry operated from a beach is not always enough. Besides, those urban jungles have their compensations. So rather than dying out, financial centres are proliferating.

Today's financial centres—the cities where big financial transactions are done and a dizzying array of financial products are traded—include not only long-established places such as New York, London and Tokyo, but also a growing number of newer financial hubs in Asia, the Middle East and beyond. As Dubai has shown, following in Singapore's earlier footsteps, a determined government can build an international financial centre from scratch.

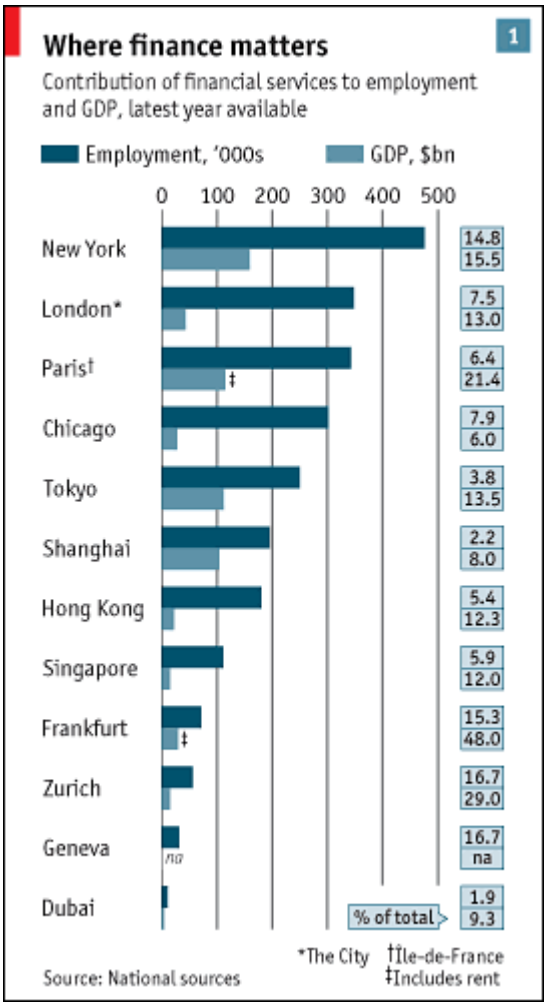
Unlike the walled medieval city-states, today's financial centres are increasingly dependent on their connections to one another. Technology, the mobility of capital and the spread of deregulation around the globe have created a vibrant and growing network. When one city is asleep, another is wide awake, so trading goes on round the clock. The number of transactions between financial centres has surged recently as investors have diversified across regions and asset types.

Yet interconnectedness has a cost. In an era of greater volatility, the latest market news spreads from one continent to another in an instant, as financiers have recently been reminded; and knock-on effects on things like bonuses and property prices soon follow.

New York and London have firmly established themselves at the top, but not even the biggest centres can afford to be complacent. New York, still number one in global financial terms by many measures (see

chart 1), has recently acknowledged the competition it faces from other centres. London has surged on a wave of new money and talent, but needs to resolve problems of its own. Some cities that once aspired to global status have lost their edge, and new ones are starting up.

Michael Klein of Citigroup cites two big changes that have encouraged the proliferation of financial centres around the globe: the shift of economic activity and jobs towards China, India and other developing countries, and growing demand for natural resources from the Middle East, Russia and parts of Latin America. The resulting shift in liquidity is “one of the greatest transfers of economic activity and wealth in the past 100 years,” says Mr Klein. With barriers to trade falling in many developing countries, the cost of capital has also fallen dramatically.



These changes have made governments in emerging countries more conscious of the benefits of a strong financial sector. More capital and more jobs are good for social and economic stability, so countries that used to rely for capital on banks, the rich or the state are allowing new capital providers into their markets. Money that used to be routed through the world's biggest hubs now often goes through non-traditional capital markets, or directly between emerging markets.

Although financial hubs have proliferated, few of them can claim to be truly global. Many members of the financial community feel that only New York City and London deserve this title. Both are one-stop shops for a full range of financial services. Any big financial organisation has to be represented there. From investment banking to insurance, stocks to derivatives, everything can be found in the world's two pre-eminent financial hubs.

What do they have that others don't? They score well on a package of key criteria that global financial firms are looking for: plenty of skilled people, ready access to capital, good infrastructure, attractive regulatory and tax environments and low levels of corruption. Location and the use of English, the language of global finance, are also important. Based on those measures, a survey by Z/Yen, a consultancy, picks London, New York and Hong Kong as the world's top three financial centres.

Finding and retaining good people has become an ever more important factor. Steven Kaplan and Joshua Rauh, a pair of economists at the University of Chicago, reckon that capital deployed per employee (the amount of money firms have invested divided by the number of staff) at the top 50 American securities firms surged from an average of $136,000 in 1994 to $1.79m in 2004. For many skilled professionals who can pick and choose their place of work, quality of life matters a lot.

Although New York and London are pre-eminent, other big cities play important international roles of their own. Some have prospered as the financial capitals of big national markets (Tokyo and Sydney) or the gateways to emerging regions (Hong Kong, Singapore and Dubai). Others have found success in niches. These include Geneva (private banking), Zurich and Bermuda (insurance and reinsurance), Chicago (futures and options), Qatar (infrastructure finance) and Bahrain (Islamic finance). Yet many of these, too, are trying to diversify.

Governments are paying more attention than ever to wooing and keeping financial firms because of the benefits they bring with them, such as highly paid jobs, large tax revenues and international connections. In New York and Hong Kong the financial sector accounts for more than one-third of total city tax revenues. In smaller centres it often makes up a large chunk of total employment.

Aside from the political and economic gains to the host countries, economists and investment bankers point to two wider benefits from having a range of financial centres around the world. One is the increase in overall liquidity as new countries and regions become integrated into the global financial system. The second is increased efficiency as competition between centres drives down the cost of trading and other financial transactions. New and developing financial centres are knocking down protectionist barriers and

emulating the regulatory practices of the more established hubs.

Making connections

The city-states that dominate today's financial world are connected not only by mobile capital and people, but increasingly by exchanges too. Exchanges have traditionally been at the heart of important financial cities. They grew up serving mainly national markets, but have changed fundamentally in recent years. A growing number are now publicly owned, which has forced them to shed their clubby ways and compete more openly.

Now they are teaming up across national borders. The first ever transatlantic merger between exchanges took place earlier this year when the New York Stock Exchange bought Euronext, a pan-European exchange group. The deal is being closely watched as a precursor to further cross-border consolidation. The London Stock Exchange is merging with Borsa Italiana, Italy's main market. Deutsche Börse is teaming up with the International Securities Exchange in New York. The big exchanges in Western countries are linking up with counterparts farther east as well, from the Dubai Mercantile Exchange to the Tokyo Stock Exchange.

This consolidation raises questions about the future relationship between exchanges and global financial centres. Exchange listing fees and affiliated services are a big source of income for host cities. Exchanges are also seen as important political prizes. But the rapid growth in cross-border trading has made life more difficult for national regulators.

This special report will examine the factors that create and sustain global financial centres and explain why physical financial hubs—teeming with banks and exchanges but also with legal, accountancy and public-relations firms and consultancies—continue to matter so much. It will also consider what their rise means for the global financial system, and how it is changing the cities that are home to these clusters.

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Friends and rivals

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From The Economist print edition

Illustration by Michelle Thompson

Two cities stand head and shoulders above the rest, and offer lessons for other hubs

SITTING in a booth in a classic Manhattan diner, Dan Doctoroff, clad in jeans and a short-sleeved shirt, is sipping a diet soda and musing about the city he loves. A former investment banker and senior executive at Oakhill Capital, a private-equity firm, Mr Doctoroff had done so well in the private sector that he was ready to turn to public life when an old friend, Michael Bloomberg, gave him a call a few years ago. Mr Doctoroff now heads New York City's economic-development efforts as a deputy to the mayor.

Mr Bloomberg's vision, his aide says, is for New York to be considered “the world's second home”. This matters in an era of globalisation when the competition for talented people is keener than ever. But New York has done many other things right (and some wrong) that offer lessons for the world's aspiring financial hubs. A remarkable number of decision-makers on matters of finance, investment and risk are still concentrated on the island of Manhattan. New York is home to six of the world's ten biggest investment firms, Mr Doctoroff notes, and pays more money to people in the financial sector than does any other place.

Despite the recent surge in the number of financial centres around the world, New York and London are ahead of the others by a large margin. And their success generates a “network effect” that makes them even more successful. They dominate not only their own national markets but their entire regions as well.

These two cities have achieved their prominence because they meet so many of the financial firms' needs. International air links are plentiful. Telecommunications networks are strong. Everyone speaks English. Legal systems are sound. Financial exchanges are robust. Talent pools are deep and multinational. And both cities offer an attractive lifestyle and range of diversions to rich financiers, who often play as hard as they work.

As institutions from other parts of the world extend their reach, most still cluster their staff and resources in and around these two cities. For instance, Nomura, a big Japanese bank, employs about 1,400 people in London, with another 400 in 12 other offices across Europe. Of its 1,200 staff in America, 90% are in New York.

Successful though they both are, the world's two leading financial centres are different from each other, and not just in style and history. They rely on different pools of capital. New York is primarily a gateway to the big American market whereas London, out of necessity, has had to look abroad for most of its growth. New York and London also have different strengths among the financial products they offer.

“[Plain] vanilla and volume is what you pay people for in New York,” says Todd Groome, a former investment banker who is now working at the International Monetary Fund. In other words, it offers straightforward products that are heavily

traded, such as equities. In contrast, London tries to profit from all the legal, tax and regulatory differentials in Europe and farther afield. “London is quite an innovative place by necessity,” notes Mr Groome. It is also a leading hub for the insurance sector, at a time when it is becoming more closely intertwined with capital markets.

Relative strengths 2

London and New York, 2006

	Value of shares traded, $trn	Value of bonds traded, $bn	New listings
London	7.6	3,305.4	547
New York*	33.6	889.8†	491

Sources: World Federation of Exchanges; NASDAQ; NYSE; LSE; SIFMA

*NYSE and NASDAQ
†US primary dealer volumes virtually all in New York

Both cities like to crow about their financial achievements. Nearly 15% of New York's workforce is employed in the financial sector, even after the attacks of September 2001 wiped out a large chunk of lower Manhattan. Slightly more than 15% of its gross output comes from the sector, as did more than one-third of its tax revenues last year. The New York Stock Exchange is by far the world's biggest market for share trading, and its recent merger with Euronext, a pan-European exchange operator, puts further distance between it and its nearest rival. NASDAQ, New York's other big stock exchange, has evolved from a secondary market dealing mainly in technology and start-up companies to a global force. Together the pair accounted for nearly half of global stock trading last year. The New York Mercantile Exchange is strong in commodities trading.

A swathe of land running from Manhattan into the state of Connecticut houses more hedge funds than any other place in the world, and correspondingly suffered from the recent market volatility. Private-equity firms, another strong (though recently battered) force in alternative investments, also cluster here. Moreover, America is estimated to handle about 40% of the world's total private-banking and wealth-management business. The new rich have been splashing out on everything from fine art to fine apartments.

London's supporters say that it surpasses New York in structured finance and new stock listings. It is especially strong on the wholesale side, accounting for 24% of the world's exports of financial services (against 39% for all of America), according to the City of London Corporation. It has a two-thirds share of the European Union's total foreign-exchange and derivatives trading and 42% of the EU's share trading.

The London Stock Exchange (LSE) claims to be the world's “most international capital market by a considerable margin”. As of mid-July it had about 320 international companies listed on its main market and 480 on the Alternative Investment Market (AIM), which is geared to smaller firms. A growing number of those new listings come from emerging markets such as Russia and China, but exchange executives are quick to point out that many of the new listings comply with American listing regulations.

The sun never sets

London's roots as a centre of commerce stretch back many centuries. It prospered as the hub of a commercial and trading nation when the sun never set on the British Empire. Now it is financial transactions that flow through London. But its rise was neither smooth nor steady. The second world war inflicted not only physical damage on the City of London but also imposed a significant human cost on the financial sector in terms of international connections and loss of knowledge. David Kynaston, an historian, notes that in the years following the war “City culture became more clubby and inward-looking than it had been 40 to 50 years earlier.” Merchant bankers recall that even in the 1970s plenty of City folk still took boozy three-hour lunches.

That began to change when exchange controls were stopped in 1979, freeing the movement of capital and opening the City up to broader international markets. Then came “Big Bang”, a series of reforms in the mid-1980s that put an end to many (though not all) of the City's outdated practices and lured a host of big American banks to the British capital. That was followed by what one economist called the “Bigger Bang”: the fast growth in offshore financial transactions funnelled through London thanks to the Euromarket. This began when London reclaimed the Eurobond market from America, a result of American tax changes that, critics say, drove the business offshore.

In an overhaul of financial regulation in 2001, a plethora of regulators was replaced by the Financial Services Authority (FSA), a single organisation that still oversees all of London's financial markets (see article). This, too, has helped London to pull ahead—even though critics say the FSA is too lax, regulators are too close to the financial sector and white-collar crime often goes unpunished.

Illustration by Michelle Thompson

Geographically, London's financial sector has expanded well beyond the City, partly in response to vertiginous office rents. Canary Wharf, a recently developed business district in the old docklands area of east London, is now home to firms ranging from Credit Suisse to HSBC and Reuters, many in high-rise offices. That has prompted the authorities in the old City's “Square Mile” to reconsider height restrictions on building and approve plans for some striking new high-rise structures.

Hedge-fund managers and private-equity firms have gravitated farther west to posh Mayfair and St James's, helping to drive up office rents there and keeping trendy restaurants busy. Financial executives of all stripes criticise London for its high prices and its overstretched infrastructure. Property is eye-wateringly expensive. Heathrow, the capital's biggest airport, is bursting at the seams, handling nearly 70m passengers a year when it was designed for 45m. Roads, trains and buses are jam-packed. But clearly for the money-men the attractions outweigh the hassles.

Two-way traffic

The rivalry between New York and London is merely the most tangible sign of a booming transatlantic business in financial services. Both centres benefit from their interconnection with each other, as well as with the rest of the global financial network. Financial flows between America and Europe have surged in recent years, propelled by forces such as mergers and acquisitions and alternative investments. America's big pension funds and other institutional investors are still some of the biggest investors in Europe's hedge-fund and private-equity markets. Many financial transactions in London are denominated in dollars. And as American exchanges have increased their business in Europe, their European counterparts—first Deutsche Börse's derivatives arm, Eurex, and more recently Euronext's LIFFE exchange—have been trying to grab a bigger share of American securities trading.

Finance has always been a strong suit in New York, dating back to the days when J.P. Morgan set up his firm's offices on the corner of Wall Street and Broad Street, opposite the NYSE. The terrorist attacks of September 2001—which hit the heart of the city's financial district—prompted fears of an exodus. Many firms shifted their back offices, some business units and support operations to neighbouring New Jersey and Connecticut. Yet many of those who left have returned. Most importantly, chief executives as well as other officials and their trusted advisers, such as law firms and accountants, remain. Indeed, JPMorgan Chase, the bank that still bears its founder's name, recently agreed to build a new skyscraper near the site of the 2001 attacks in lower Manhattan.

Other changes have been more forward looking. The NYSE has recently embarked on a round of acquisitions and collaborative deals in an effort to become a trend-setter in technology as well as globalisation. NASDAQ has fired up too. It took a 31% stake in the LSE after an attempted takeover was rejected, then announced plans to sell it again in pursuit of OMX, another exchange operator.

The 2001 attacks also helped to change the way America thought about regulation. Coupled with financial scandals such as that over Enron, the events increased political pressure for acting on potential abuses by executives and greater scrutiny by investors. At the same time Eliot Spitzer, then New York's attorney-general (and now its governor), embarked on a mission to hunt down financial wrongdoing in corporate and financial markets. His zeal won over many consumers in New York, but it did not go down

well in international capital markets.

A string of reports released earlier this year—by groups ranging from McKinsey, a consultancy (at the behest of Mr Bloomberg and Senator Charles Schumer), to the pro-business US Chamber of Commerce—has pointed to problems in America's capital markets ranging from regulatory scrutiny to accounting standards and obstacles to immigration. The worry is that rival hubs, notably London, are attracting some of the financial business that New York would like for itself. “Facts are facts,” says Mr Doctoroff of the reports, which involved extensive interviews with chief executives of big financial firms. “Few people are disputing the analysis we've done.” But many of the changes suggested by the reports will need to come from Washington, DC, where America's regulators sit.

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Boutique shopping

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If you can't be the biggest, offer something special

NEW YORK and London may rule the roost, but other financial hubs in America and Europe have managed to carve out useful specialist niches for themselves. Chicago, for instance, consolidated its position as the world's derivatives centre earlier this year with the merger of CME (formerly the Chicago Mercantile Exchange) and the Chicago Board of Trade (CBOT). Now known as the CME Group, the former cross-town rivals trade everything from Treasury bond futures to pork bellies. But in recent years the colourful open-outcry trading floors have gradually ceded business to electronic transactions.

Houston, the largest city in Texas, is home to America's biggest energy firms, which have spawned an active cluster of energy traders and hedge funds. And Boston, with plenty of serious wealth, has become a centre for asset management and private equity.

Europe has developed a diverse set of financial centres ranging from big cities to island havens such as Jersey and niche markets such as Luxembourg and Dublin. Edinburgh, an established banking centre, is now touting itself as a low-cost alternative for financial operations.

Among the larger hubs, Frankfurt is an important centre for banking and derivatives trading through Eurex, a German-Swiss exchange, with significantly lower costs than London. It is also home to the European Central Bank. Fifteen years ago Frankfurt aspired to become a global financial centre, but these days German financial giants such as Deutsche Bank and Allianz do much more business in London than in Frankfurt. The exchange has had a difficult few years, including a couple of failed forays abroad.

Switzerland's twin financial centres, Geneva and Zurich, have done well in their specialities of private banking, wealth management and, in Zurich, insurance. About 40% of the banks operating there are foreign. Hedge funds, private equity and traders in structured products are also moving in. The main attractions are low taxes, stability and a reputation for discretion. Urs Roth, of the Swiss Bankers Association, says that given its tiny domestic market, Switzerland has had to fight for open markets on an international scale. But it is now facing competition from places such as Singapore.

Paris has long lagged far behind London, dogged by a reputation for excessive regulation and high taxes. The new government of Nicolas Sarkozy is aware that some of France's best financial brains have crossed the Channel for more lucrative careers in the City. Yet Paris has many advantages: a large number of international banks, from BNP-Paribas to Crédit Agricole; more international companies than Frankfurt; and easy access to regulators. It also has the largest market in Europe for trading in mutual funds. Few would dispute that it offers an attractive quality of life, and it has good transport links. But its labour market is not as international as London's.

International chic

What makes Paris a place to watch just now is the NYSE's recent merger with Euronext. The combined group will base its international equities business in the French capital. Euronext, which operates exchanges in five European countries, also illustrates the importance of a common language. Although senior European executives at the merged exchange are based in Paris, it has adopted English as its official language. But several financiers lament that French government ministers tend to stick to French in public. One honourable exception to this French rule is Christine Lagarde, the new finance minister. She spent some years in Chicago and sprinkles her speeches with English phrases.

Financial executives around the world increasingly view Europe as a single market. On November 1st a new European rule called MiFID (Markets in Financial Instruments Directive) is due to be implemented. This aims to increase competition among and transparency within financial markets. Financiers in other parts of the world are wondering how to achieve a similar degree of cross-border financial integration.

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All shapes and sizes

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Asia's financial centres reflect its vast geography and divergent economies

Illustration by Michelle Thompson

LOCALS and foreign visitors alike enjoy a stroll along the Bund, the famous embankment along the Huangpu river in Shanghai. With performers, pedlars, couples and families all milling around, the waterfront has a carnival-like atmosphere. Behind it, a string of historic buildings—from the old Peace Hotel to a granite dome that used to house the Hongkong and Shanghai Bank—recall the Bund's glory days as the Wall Street of China.

But today the real attraction is on the opposite bank of the Huangpu, where the Pudong financial district is sprouting new skyscrapers at a remarkable pace, most of them the work of well-known architects from around the world. The 88-storey Jin Mao tower, currently the tallest in China, houses a spectacular Grand Hyatt hotel as well as the offices of international firms ranging from Société Générale to Aon. Next year it will be overtaken by the Shanghai World Financial Centre. Nearby the Oriental Pearl Tower sports futuristic pink bulbs that form a favourite backdrop for holiday snaps. As the skyscrapers rise in Pudong, the luxury-goods shops in the upmarket quarters of the city do steady business, and old buildings along the Bund are getting new leases on life as smart restaurants and bars.

The Shanghai Stock Exchange offers further evidence that this city is awash with money. The leading market index has surged by more than 300% in the past 18 months. Foreign investors are clamouring for a bigger share of the action, but the authorities have kept capital controls in place to ensure that most of it goes to the Chinese domestic market.

An estimated 70-90% of investors on the Shanghai exchange are individuals (“retail”, in the industry jargon). Perhaps 300,000 new retail trading accounts are being opened every day, and about 50m Chinese have accounts. Some people are taking out loans on their houses to funnel more money into the stockmarket, fuelling a boom in property as well. Insider trading is said to be rampant. “It is a remarkable cocktail to manage as a regulator,” says a British lawyer who works in China.

The government is trying to maintain control without unduly hampering the market's growth. A key element of that control is the Chinese currency's lack of convertibility. In an effort to calm the stockmarket frenzy, the authorities earlier this year tripled the stamp duty charged on transactions. When further dampening measures were put in place the market dropped in late May and early June, but the trend during the summer was firmly upward.

Controls also remain on trading in derivatives, a fast-growing sector trying to handle the country's big appetite for commodities and financial products alike. The China representative for Calyon, a foreign brokerage that has a joint venture with the government-backed CITIC, says it is inching towards approval from the authorities that will allow it to enter the market.

There are some glimmers of light for foreign companies looking for openings. The insurance sector has been partly liberalised, thanks to an agreement reached during the negotiations over China's accession to the World Trade Organisation. Firms ranging from AIG (a long-time presence in the region) to Aviva (a relative newcomer) are planting their flags across China. Restrictions on foreign banks are gradually being eased. And in one of the more intriguing signs that China seeks further engagement abroad, its government recently bought a stake in Blackstone, a big American private-equity firm.

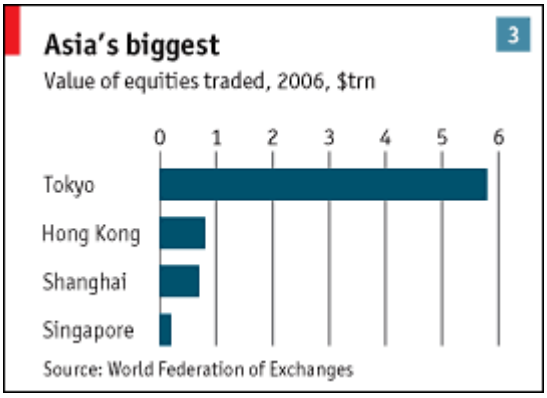
As for Shanghai, the Chinese government wants to make it a great financial centre again, as part of its broader goal of “leading China out of poverty into a glorious future,” says an analyst in the city. But for all the money and business flowing into Shanghai these days, it also shows up all the problems of emerging financial centres in developing markets. Many foreign visitors arriving at its international

airport travel to the city on a Maglev train, the world's fastest, which can reach 430km (267 miles) an hour. But it terminates miles from the city centre. Like the Maglev train, Shanghai needs further development to meet global standards.

Size doesn't matter

Shanghai is just one of several important financial hubs in Asia. Unlike in America and Europe, though, no single Asian hub has yet emerged as a clear leader. At present the lion's share of equities traded in the region goes through Tokyo, Hong Kong, Shanghai and Singapore (see chart 3). There are also plenty of smaller financial centres, from Sydney to Seoul. But Shanghai's and Mumbai's hopes for regional leadership have yet to be realised.

There had been worries that Shanghai would steal Hong Kong's thunder, but the former British colony remains a vibrant place for stock listings, mergers and other financial transactions. Hong Kong recently marked its tenth anniversary as a special administrative region of China and remains the international gateway to mainland China and Taiwan.



A slew of international investment banks, ranging from Goldman Sachs to Allianz, ABN Amro and BNP Paribas, have offices in Hong Kong, as do many international hedge funds, private-equity firms and insurance companies. A variety of home-grown firms play an important regional and international part. The legacy of British colonial rule—including the widespread use of English, a Western-based legal system and international standards of corporate governance—continues to serve Hong Kong well a decade after the handover to China. Support services such as international law firms, whose operations remain highly restricted on the mainland, base themselves in Hong Kong. One-third of Hong Kong's company stock listings and about half of the market capitalisation on the financial exchange come from mainland Chinese companies, including the successful joint listing last year of ICBC in Hong Kong and Shanghai.

Financial services have become more important to Hong Kong's economy as its manufacturing base has shifted across the border. Given Hong Kong's space restraints, that has been all to the good. But costs have soared in recent years, air quality has deteriorated and traffic jams seem worse than ever. You hear a lot of stories these days about fund managers moving to Singapore to get away from the smog.

But for any firm that is serious about the China market, Hong Kong is a must—and Shanghai is as yet no substitute. The price differential in stocks listed dually in Shanghai and Hong Kong tells its own story. Martin Wheatley, who used to work at the London Stock Exchange and is now the chief market regulator in Hong Kong, puts the premium for shares listed there at about 50%. He and others say that Hong Kong's stringent regulatory standards give any Chinese firm listing in the territory an instant credibility boost in the eyes of foreign investors. Whether and when this gap narrows is a matter of close interest across the region. “Hong Kong aspires to be the Wall Street of China, and Shanghai is its only competitor in this region,” says a Hong Kong based lawyer.

Tiny Singapore, like Hong Kong, has long had to rely on its ingenuity to succeed. Compared with the relatively free-wheeling capitalism of Hong Kong, Singapore has a much more managed economy. Decisions are taken and implemented swiftly. Only a couple of decades after the government identified finance as a priority sector, Singapore has a thriving financial exchange, is considered a prime hub for wealth management and has a growing number of boutique hedge funds.

Singapore owes its success as a financial centre to a combination of economic and political stability, financial incentives and a willingness to build international bridges, as well as a leafy and calm (if steamily tropical) environment. Critics consider it dull, increasingly costly and too heavily influenced by government. Foreign law firms are restricted there as well.

Growth in private banking has been especially strong. Official estimates put the size of the wealth-management market at $200 billion-$300 billion, but some in the industry reckon it could be twice that. It has helped that smaller “boutique” funds are very lightly regulated. “You can become a money manager almost overnight,” says one analyst.

Singapore's financial exchange, SGX, trades both stocks and derivatives. It has become increasingly global in recent years, and about two-fifths of its market capitalisation now comes from foreign companies. SGX has tried to specialise, creating liquid markets in sectors such as shipbuilding and property.

A bull market in derivatives has prompted trading volume to surge in the past few years, says Seck Wai Kwong, a leading exchange official. SGX has been collaborating with Chicago's CME for over 20 years, has explored a retail link with the Malaysian exchange and has a 5% stake in the Mumbai bourse. In June the Tokyo Stock Exchange, Japan's leading exchange, took a stake of nearly 5% in the SGX. The city-state has become a popular outpost for Japanese financiers and their families, who are drawn to its stability and lifestyle.

Singapore has also positioned itself as a gateway to India, drawing on its cultural ties with that country (a sizeable portion of Singapore's population is of Indian origin). But Mumbai itself, too, hopes to become a global centre in the medium term. With a population of 1.2 billion and a fast-growing economy, India holds great promise for the world's financiers. For now, though, it is less of a global hub than an important national centre.

The vast majority of investors on India's exchanges—some reckon as many as 95%—are individuals rather than institutions. “No product in India can succeed unless there is retail support,” S. Ramamurthy of the National Stock Exchange told financiers in London recently. He estimates that foreign institutional investors account for about 10% of the volume of Indian stocks. As in other developing markets, the aim is to increase the number of institutional investors over time to give the markets more depth and maturity.

Illustration by Michelle Thompson

For the moment, though, protectionist regulations and poor infrastructure make Mumbai a difficult environment for international financiers, though there are hints of change to come. “The Indian government is making all the right noises” about opening its markets, says one of them. Among the changes they would like to see is an end to the current strict limits on foreign participation in the markets.

Meanwhile, though, a growing number of Western investment banks and insurers are outsourcing their back-office operations to India. For their part foreign exchanges also note that India is an especially popular location for trading arcades—computer-filled rooms where active traders buy and sell financial instruments, either on their own account or for proprietary trading firms—which are having an impact on international markets.

Catching up on a lost decade

Tokyo is by far the biggest financial centre in Asia, although it caters largely for the domestic market. It has been an important financial hub for centuries, and is home to some of the world's largest corporations. The Tokyo Stock Exchange (TSE) is the world's second-largest share market. But Tokyo's financial firms and some politicians are waking up to the fact that other Asian cities are grabbing a bigger share of the surging financial flows in the region. The government has embarked on various reforms intended to make Tokyo more attractive as a financial centre. For instance, the financial sector's regulator has announced plans to rearrange the firewalls between banking and trading securities to allow financial groups to serve their customers better.

The TSE, having suffered a series of hitches, some of them technological, is trying to become more effective. Hence the 5% stake in Singapore's SGX, and plans to go public in 2009. Yet reform will not come quickly or easily.

Tokyo's financial sector still seems haunted by a “lost decade” when economic woes prompted Japan to retreat from its role as a top international investor in the 1980s. Banks, the bedrock of the financial sector, went through a crisis in the 1990s and pulled back from the capital markets as well. Bank lending remains relatively more important in Japan than in America, where capital markets are much more active. Taxes are high. Regulation is seen as inefficient, excessive and unwelcoming to foreigners.

Accounting rules differ from the most widely accepted international standards.

Even so, foreigners dominate activity in the financial markets. One Western executive says young Japanese investment bankers typically have far less experience of deals than their counterparts in London or New York. Once the brightest and best Japanese graduates went for jobs at big Japanese banks; now more and more of them are being recruited to firms such as Goldman Sachs or UBS.

One of the things that differentiates Asia is that few big financial exchanges have demutualised and gone public, a process that has increased efficiency and competition in the West. And for all its booming stockmarkets, Asia also remains cautious about more innovative areas of finance, such as derivatives and the short-selling (betting that a stock will fall) so popular with Western hedge-fund managers. Painful memories of the Asian financial crisis in 1997 still linger. Many of Asia's capital flows are still channelled through global investment banks with headquarters in New York or London.

Wait for it

To Paul Chow of the Hong Kong exchange, Asia's multiple and varied financial centres reflect not only the region's vast geography but also its different economic realities. “At the end of the day there is no one solution for all,” he says. “Everyone is at different stages of development, facing different challenges.” But in 20 years' time, he adds, the picture is likely to look much more like that in the West.

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A bouquet of desert flowers

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Where sand and finance mix

IF YOU want to see what it takes to set up an entirely new financial centre (and what is best avoided), head for Dubai. This tiny, sun-baked patch of sand in the midst of a war-torn and isolated region started with few advantages other than a long tradition as a hub for Middle Eastern trade routes.

But over the past few years Dubai has built a new financial centre from nothing. Dozens of the world's leading financial institutions have opened offices in its new financial district, hoping to grab a portion of the $2 trillion-plus investment from the Gulf. Some say there is more hype than business, but few big firms are willing to risk missing out.

Dealmaking in Dubai centres around The Gate, a cube-shaped structure at the heart of the Dubai International Financial Centre (DIFC). A brainchild of the ruling al-Maktoum family, the DIFC is a tax-free zone for wholesale financial services. Firms licensed for it are not approved to serve the local financial market. The DIFC aims to become the leading wholesale financial centre in the Gulf, offering one-stop shopping for everything from stocks to *sukuk* (Islamic) bonds, investment banking and insurance. In August the Dubai bourse made a bid for a big stake in OMX, a Scandinavian exchange operator that also sells trading technology to many of the world's exchanges.

Dubai may have generated the biggest splash thus far, but much of the Gulf region has seen a surge of activity in recent years. Record flows of petrodollars have enabled governments in the area to spend billions on infrastructure projects and development. Personal wealth too is growing rapidly. According to Capgemini and Merrill Lynch, the number of people in the Middle East with more than $1m in financial assets rose by nearly 12% last year, to 300,000.

Qatar, Bahrain and Abu Dhabi also have big aspirations for their financial hubs, though they keep a lower profile than Dubai. They, too, are trying to learn from more established financial centres what they must do to achieve the magic mix of transparent regulation, good infrastructure and low or no taxes. Some of the fiercest competition between them is for talent. Most English-speaking professionals have to be imported.

Making oil money stick

Each of the Gulf hubs, though, has its own distinct characteristics. Abu Dhabi is trying to present itself as a more cultured, less congested alternative to neighbouring Dubai, and is building a huge Guggenheim museum. Energy-rich Qatar is an important hub for infrastructure finance, with ambitions to develop further business in wealth management, private equity, retail banking and insurance. Bahrain is well established in Islamic banking, but it is facing new competition from London, Kuala Lumpur and other hubs that have caught on to Islamic finance. “If you've got one string to your bow and suddenly someone takes it away, you're in trouble,” says Stuart Pearce of the Qatar Financial Centre about Bahrain.

Saudi Arabia, by far the biggest economy in the Gulf, is creating a cluster of its own economic zones, including King Abdullah City, which is aimed at foreign investors seeking a presence in the country. Trying to cut down on the number of “suitcase bankers” who fly in from nearby centres rather than live in the country, the Saudis now require firms working with them to have local business licences. Yet the bulk of the region's money is still flowing to established financial centres in Europe, America and other parts of Asia.

The financial hubs there offer lessons for aspiring centres in other parts of the developing world. Building the confidence of financial markets takes more than new skyscrapers, tax breaks and incentives. The DIFC, for instance, initially suffered from suspicions of government meddling and from a high turnover among senior executives. Trading on its stockmarket remains thin, and the government seems unwilling to float its most successful companies there. Making the desert bloom was never easy.

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Marketplaces on the move

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Bourses have become hugely more effective

Illustration by Michelle Thompson

FOR most of human history, exchanges involved physical contact. Whether trading gossip, gold or grain, people came together to give and take in a manner that was both social and, with luck, economically beneficial. Marketplaces, the forerunners of exchanges, were the heart of early financial centres.

Once professional brokers got in on the act, though, the nature of exchanges began to shift. Buyers and sellers lost some of their close contact with markets. Transactions became more complex, involving for instance the right to buy and sell goods in the future at a price fixed in the present. The brokers promised efficiency and superior returns, but some put their own interests above those of their clients. Outsiders had to take it on trust that all the shouting and hand-waving by men in brightly coloured jackets meant they were paying, or being paid, a fair price.

Over the past decade financial exchanges have changed out of all recognition. From Stockholm to Singapore, they have modernised and expanded. Fortunately for investors, most of the changes have been for the better. They have brought more choice, faster trading and greater efficiency. Trading costs have come down, too. This matters to financial centres, because exchanges are still at the heart of the world's financial network.

Much of the transformation is being driven by the increasing sophistication of investors and financial intermediaries, particularly big investment banks, which direct the bulk of capital flows around the world. “Give a call to Goldman and you have a choice of all these global exchanges,” says an official in Asia. Regulation has played a role as well. In both America and Europe, politicians have introduced rules aiming for greater transparency and competition.

As a result, the world's biggest exchanges are vying as never before for a share of highly mobile global capital. Their vast computerised hubs and their ability to zip transactions around the world in split-seconds allow them to play a dual role reminiscent of the marketplaces and sailing ships of medieval times. The most successful are those with attractive goods on offer, competitive prices and speedy response times.

Given the rise of electronic trading, exchanges may have become more virtual than physical marketplaces, but the broader impact of exchanges on cities—their “multiplier effect”—keeps on growing. An official at the London Stock Exchange notes that although its total listing fees (as opposed to trading fees) in the past financial year were a relatively puny £28m ($56m), fees generated by advisers to new companies on the exchange—lawyers, investment bankers, accountants, public-relations firms and so on—were estimated at £3.5 billion.

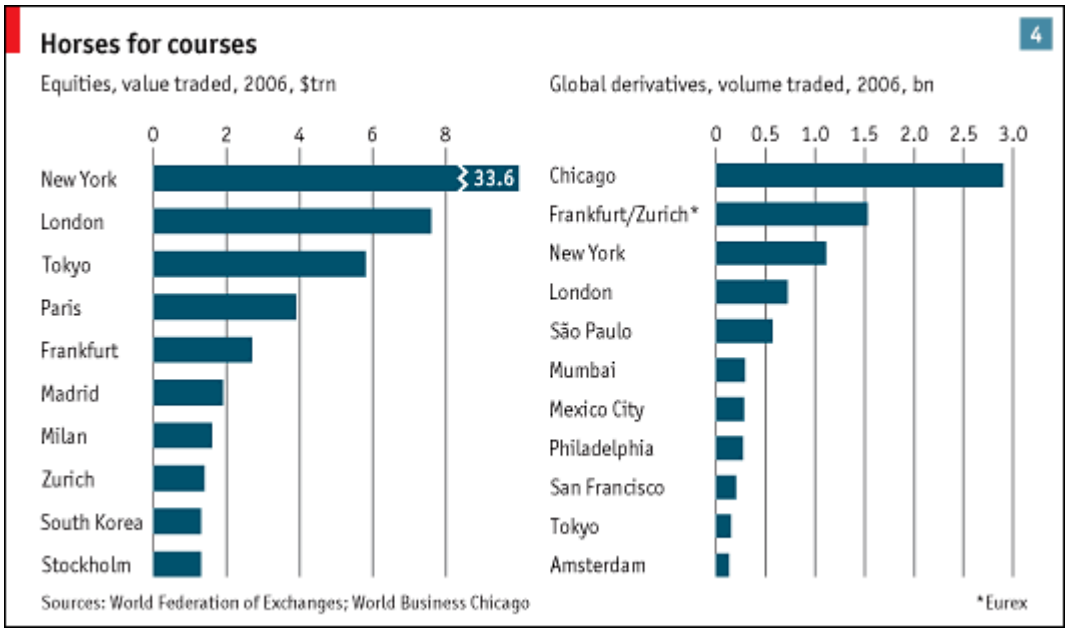
Three things that changed the system

John Thain, head of the New York Stock Exchange, notes three key trends in the evolution of modern exchanges: demutualisation, diversification and globalisation. These are already having a profound effect on the global financial system—and are linking financial centres more closely together than ever before.

Demutualisation is an industry term for the end of market ownership by a small, privileged group of “seat owners”. Seat ownership typically confers not only the right to trade but also a say over the way an exchange is governed. But a growing number of these insiders' clubs have voted to end their exclusive ownership rights and sell shares in the exchanges to public shareholders. This has mostly resulted in

greater efficiency, new investment in modern trading technology and a better deal for investors.

Big exchanges in Europe—ranging from Deutsche Börse to the London Stock Exchange and Paris Bourse—were at the forefront of demutualisation in the 1990s. Their share prices have since soared. In recent years America's biggest exchanges have followed suit, with remarkable success. First came the Chicago Mercantile Exchange (CME), whose share price has rocketed since it went public in 2002. Since then a series of stock and derivatives exchanges, including NASDAQ, the NYSE and the New York Mercantile Exchange, have gone the same way. One benefit of demutualisation has been that it gives exchanges the flexibility to merge.



The second trend, diversification, means the exchanges are trading a broader range of products. For most of their history, stockmarkets traded companies' shares in the countries or regions where they were based. Derivatives exchanges grew up offering contracts for the future delivery of commodities that were often produced, imported or widely traded nearby. These days exchanges trading derivatives are highly imaginative in creating new products. They have expanded well beyond commodities to offer contracts tied to anything from foreign currencies to the weather.

Different stock exchanges have taken different paths to diversification. One strategy is to reach into a competitor's territory for share listings, as NASDAQ is doing by offering parallel trading in shares of NYSE-listed companies. Another route is the listing of foreign-based shares. In Asia, for instance, the Hong Kong and Singapore exchanges list shares in Chinese companies. In Europe, the London Stock Exchange has been actively courting foreign listings for a number of years, with a recent surge in listings from developing markets such as Russia. And in America, companies from Brazil and other emerging markets have long listed American Depository Receipts (ADRs) in New York.

Diversification is a means for exchanges to benefit from fast-growing or especially profitable parts of the financial markets. It can bring savings by spreading the fixed costs of operating an exchange over a greater number of products. And it offers a broader product mix to investors, especially those who want to trade multiple assets simultaneously. Hedge funds—lightly regulated pools of money geared to sophisticated investors—are known for trading many assets at once.

Diversification has also been one of the motives for the recent round of exchange consolidation. For the NYSE, for instance, the merger with Euronext offered not only access to European share trading but also to the LIFFE derivatives market, which trades in both Europe, America and Asia. The CME's merger with the Chicago Board of Trade (CBOT) has created a derivatives powerhouse that trades a wide cross-section of products. The LSE has said that one of the benefits of its recent merger with Borsa Italiana was access to the Milan exchange's bond business. The proposed tie-up with OMX, a Scandinavian exchange operator, would offer NASDAQ access to widely used trading technology.

A sticky situation

Yet there is no guarantee that attempts at diversification will succeed. It is notoriously difficult to shift a country's investors away from their established exchanges. The “stickiness” of liquidity is especially evident in derivatives trading, in which exchanges not only create their own products (as opposed to trading share listings) but also control trade clearing and settlement systems. More liquid markets generally result in narrower bid-ask spreads, which means better prices for traders. For the moment this is compensated for by higher trading volumes, but a credit crunch might put an end to those.

The third trend, globalisation, is really another sort of diversification. This can involve the listing of foreign shares or depository receipts, alliances to exchange information or technology, or cross-border mergers. By reaching across national boundaries, exchanges are offering their customers a new mix of products as well as reducing costs and increasing profits. However, as in any cross-border merger they run the risk of over-complexity and integration difficulties. They also expose themselves to issuers who may not be governed by the robust accounting standards of the world's leading financial centres.

Despite all this consolidation, the World Federation of Exchanges still counts 54 bourses among its members, which between them account for 97% of global stock trading. The remaining minnows are likely to be swallowed up in future.

The NYSE-Euronext merger is the most ambitious attempt yet at cross-border exchange consolidation. Executives on both sides of the merger acknowledge that there are still barriers to integrating the exchanges, ranging from distance and time zones to differences in culture and business practice.

Regulation remains a resolutely national affair (see article), posing another challenge in cross-border consolidation. Exchanges in America and Europe are at the forefront of change, partly because their capital markets are most developed but also because of regulatory shifts. New laws in both regions—a rule known as Reg NMS in America, and MiFID in the European Union—are pushing them toward greater transparency and competition.

Electronic threats

The new rules are also encouraging upstart competitors such as Project Turquoise, a trading platform created by a group of large investment banks. Thanks to rapid advances in trading technologies, such electronic newcomers are trying to lure business away from more established operators in both Europe and America. The changes have already encouraged more technology investment and more collaboration by the big exchanges on both sides of the Atlantic.

The exchanges are also being pushed to offer greater speed and the capacity to handle floods of orders from computer-generated “algorithmic trading” programs, which are popular with hedge funds. Some big exchanges reckon that at least one-third of their trading volume comes from these programs.

Exchanges will matter for financial centres as long as they generate a significant multiplier effect in terms of revenue and jobs. They are also important political prizes for their host cities and countries. The world's top financial centres—New York, London, Hong Kong—seem likely to consolidate their positions as key exchange centres. One important reason for their continuing success is the quality of their regulation.

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The rules of the game

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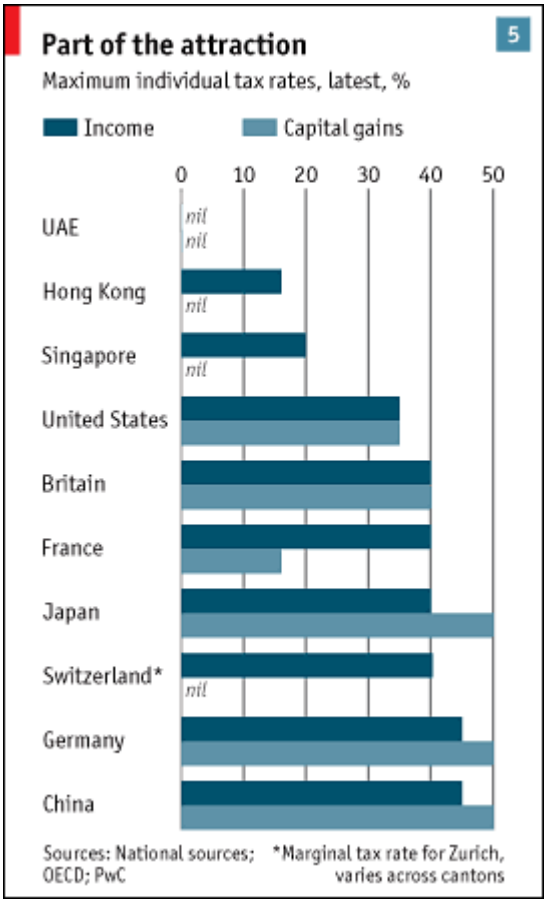
Regulation is an important component of a financial centre's success



AMID all the transatlantic debate over who has the better financial rules, it has been easy to lose sight of the common roots of Anglo-American securities regulation. Although the market for trading securities that developed in late 17th-century London was something new, securities were similar in many ways to older forms of property. In those days English attitudes towards speculation in anything from food to land were ambivalent, and speculation in money had long been frowned upon. A lot of speculative activity at the time was therefore either illegal or tightly regulated.

That applied to securities too, and some of these attitudes made their way across the Atlantic. From the late 17th to the mid-19th century English and American securities markets were heavily regulated, in some ways more so than they are today. Even so, many people were quite willing to trade with speculators.

This ambivalence is still evident in certain aspects of American securities regulation. The suspicion between Wall Street and Main Street—between financial professionals and the wider population, which is wary of their power and practices—remains to this day. Many current rules, such as those against deception and price manipulation, were first put forward in the late 17th and early 18th century.

Whereas financial markets have undergone huge changes, regulation has often lagged behind. Newly established financial centres, keen to become part of the global financial network, are increasingly looking abroad for lessons in regulation and adopting internationally accepted regulatory practices.

Financial innovation has proceeded at a head-spinning rate in recent years. Hedge funds have ballooned to account for more than $1.3 trillion in assets worldwide. They also bear some responsibility for the growing volatility of global financial markets and pose difficult questions for regulators. Complex new products that are created in one financial centre involve assets in another and are sold to investors in a third, so who is supposed to keep an eye on them?

“It's almost a virtual system,” says one regulator in a leading financial centre. Increasingly capital markets are racing ahead of the regulators, which remain rooted in their national systems, thus creating problems for financial firms straddling borders. Technology may have made electronic transactions faster and cheaper than ever, notes an international banker, but it is also making regulatory barriers less visible to clients.

That lack of visibility raises worries over risk, too. Many argue that risk is now dispersed more widely than ever before, across geographical areas, financial institutions and investors. This dispersion, the argument goes, allows the financial system to absorb the stresses of a rapidly growing system.

Others are less certain. It is hard to know exactly where the risks are when they have been divided up, repackaged and sold off. This may seem a concern only for financial institutions and large investors. But with a growing number of individuals exposed to capital markets—from Americans through their mutual funds and retirement accounts to small investors in Shanghai taking out loans to buy shares—governments cannot afford to ignore those risks.

It is up to regulators, who are generally appointed by and report to government, to sort out the balance, but the complexities of rapid trading, particularly across multiple borders and asset classes, are stretching the capacity of even the most sophisticated regulators.

The current debate over regulation has concentrated largely on the American and British approaches, which have diverged in recent decades. Both are hugely important markets for the global financial system. Increasingly, firms have choices about where they do their transactions, list their shares and keep their staff. There is talk of “regulatory arbitrage”, meaning that financial firms look for the most favourable environments to operate in. Emerging financial centres are watching closely as they draw up their own rules.

Current American financial regulation—divided among many agencies at both federal and state levels—strikes many firms as complex and confusing. The Securities and Exchange Commission (SEC), which regulates share trading, banks and other parts of the financial markets, takes a “rules-based” approach, spelling out in detail what can and cannot be done. It was developed in the 1930s in response to the Depression, and many financiers concede that it may be better suited to times of crisis than to more normal conditions. The Commodities Futures Trading Commission (CFTC), which monitors the futures markets, is generally more risk-based and less legalistic than the SEC—more like Britain's Financial Services Authority (FSA).

Eating New York's lunch

The debate over regulation is noisiest in America. There are worries in financial circles that markets there—and particularly New York—may be losing some of their business to financial centres abroad. “The United States is at a total disadvantage to a country that saw what it did, learned from the mistakes and adapted its regulation,” says Gary DeWaal, the New York-based general counsel for Fimat, a global brokerage. He calls for “a Big Bang overhaul of financial regulation”.

Many in the financial community have called for America to combine its jumble of financial regulators under a single umbrella, as Britain has done with the FSA, but views on what exactly should be done are far from unanimous. Mr DeWaal suggests a “quadrant-based system” in which business done by sophisticated clients (institutional investors and rich individuals) would be covered by light regulation, whereas more vulnerable clients (including most individuals) would be protected by tougher rules. But many individuals have invested their retirement savings and other funds in products managed by institutions. If pension funds put more money into alternative investments such as hedge funds, a wider range of investors is at risk if a big fund blows up.

Officials at Chicago's CME staunchly oppose the idea of a single financial regulator. The big futures group is regulated by the CFTC, which recently approved its merger with CBOT. A merger of the CFTC and the SEC would cause the futures industry to stagnate, argues Craig Donohue, the CME's president. Terry Duffy, the CME's chairman, takes the same view: “We would fight it tooth and nail, and I think Congress would too.”

Illustration by Michelle Thompson

A regulatory merger in America, then, appears to be a political non-starter for now; but there are many other ideas for making America's capital markets more competitive. Some of the proposals in the recent McKinsey and Chamber of Commerce reports, such as increasing acceptance of international accounting standards (which take a different approach from America's GAAP), have already been taken up by the SEC. Until now foreign firms doing business in America have been required to keep two sets of books, which is time-consuming and expensive. Other recommendations, such as changes to a legal system that makes class-action suits much more common than in other countries, will be harder to implement.

The reports' recommendations have been applauded by a slew of senior executives, including Mr Thain of the NYSE. In America, he laments, regulators are “much more interested in handing out fines than necessarily resolving problems”.

Much of the financial world's grumbling in recent years was directed at Eliot Spitzer, the former attorney-general (and now governor) of New York, who cracked down so zealously on the private sector that his name became synonymous with heavy-handed regulation. But some financiers suggest that the national regulators in Washington, DC, have been just as tough on the sector. “The SEC would out-Spitzer Spitzer,” says a top investment banker. Ironically, Mr Spitzer is now working to improve the competitiveness of New York's capital markets. “He's not perceived as a friend of the industry, and he's beginning to capitalise on that opportunity,” says Mr Doctoroff, the deputy mayor.

The Sarbanes-Oxley act, passed five years ago, which imposed far tougher controls on public companies, is also often blamed for making America a less attractive place for doing business.

The industry's concerns have been noted in Washington, DC. President Bush has asked Hank Paulson, America's treasury secretary (and former boss of Goldman Sachs), to convene a group of experts to consider competitiveness in financial markets. This is a tacit acknowledgment that financial firms often have a choice over where to base themselves, and regulatory regimes will play a part in that.

Britain's financial system, which has served as a model for regulators from Hong Kong to Dubai, is based on broad principles and “risk-based” regulation. Stocks, futures products, banking, insurance and over-the-counter products (private transactions between parties) are grouped under a single regulator, the FSA. Executives from financial firms are routinely seconded to spend time in the regulator's office, making for a perhaps overly cosy relationship between the public and private sectors.

Criticism of the British approach centres on two main areas: enforcement and the emphasis on wholesale services. The FSA has issued far fewer fines than its American counterparts. Some fret that too much insider trading and white-collar crime goes unpunished in a system that, for all its modernisation in recent years, often still relies on an old-boy network.

Defenders of the system say the British regulators are more interested in dialogue than strict discipline, but many concede that this approach works better for wholesale financial services—professionals dealing with professionals—than for the retail services that affect ordinary people. Given the increasing importance of international financial transactions in London, the emphasis on wholesale services seems likely to continue. The new head of the FSA, Hector Sants, is a former banker who most recently ran the FSA's wholesale-markets division. When he took office this summer he acknowledged concerns about retail regulation and vowed to pay more attention to it.

Christopher Cox, chairman of America's SEC, notes that Britain's regulators are more relaxed about where a firm is domiciled than are their American counterparts. In an increasingly global economy, that may be a useful attitude—but then some of the issuers have less-than-pristine standards of corporate governance.

Miffed by MiFID

Yet there is an added layer of regulatory complication in Europe as the European Commission in Brussels pushes for a single regional market in financial services. From November 1st European financial-services providers will be subject to the Markets in Financial Instruments Directive (MiFID), designed to increase competition and improve transparency across a broad swathe of financial services. Financial firms may grumble about the cost of implementing it, but MiFID has already changed attitudes in Europe's financial markets. Michel Prada, chairman of the French financial regulator, the AMF, reckons that it will be a big issue for months and years to come.

London, as the region's biggest financial centre, has much to gain, but could also lose from MiFID. The LSE, for instance, derives a significant proportion of its income (some estimates put it as high as one-third) from trade-reporting services. In anticipation of the new rule, other financial-data providers have already set up shop in hopes of diverting some of this business from the exchange.

Because of the increasingly global nature of capital markets, these regulations are being tested in new ways. The growing volume of cross-border exchange deals, for instance, has forced regulators to work much more closely together. “Just as the United States can't go it alone, neither can any other country,” says the SEC's Mr Cox.

Within Europe, a collaborative approach to exchange regulation has been reflected in the creation of Euronext. Mr Prada notes that the European regulators have gradually taken on a more serious role.

“Before, we were talking about philosophical issues,” he says. “Now we have firms that will demand synergies. This is new and very important.”

The NYSE-Euronext merger, which groups financial exchanges in five European countries with the Americans, has been particularly important in nudging regulators from different backgrounds closer together. Parties on both sides of the Atlantic have had their difficulties with that. One NYSE official laments the time spent “fighting shadows”, meaning European concerns over America's strict regulatory approach.

The Americans, for their part, are trying to work towards what Ethiopis Tafara, an SEC official, calls recognition of “like-minded regulators”. But, he adds, political realities will ensure that “we will never get identical regimes in each system.”

Politics gets in the way

It is politics that finally drives regulatory reform. Real change in Washington, DC, ultimately depends on Congress. But insiders on Capitol Hill doubt that much will get done before the 2008 presidential election. Mr Cox, who himself spent 17 years in Congress, takes the same view, noting that the legislative branch moves to its own rhythm. Besides, reform of financial markets is seen as important to only a select few states, such as New York, Connecticut (home to numerous hedge funds) and Illinois, all of which have big financial sectors.

Financial firms, for their part, complain that drawn-out debates over regulation are too complex, too philosophical and too political. “We want to write a contract very quickly,” a Citibank official explained at a recent financial-services conference. But the shifting regulatory sands make it hard to achieve such simple aims.

Even as technology, capital flows, product innovation and clients are racing ahead to become increasingly global, regulation is still rooted in the era of the nation-state. “Sovereignty is going to remain,” says Mr Tafara. It seems that Main Street still has a voice on Wall Street.

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Enduring attraction

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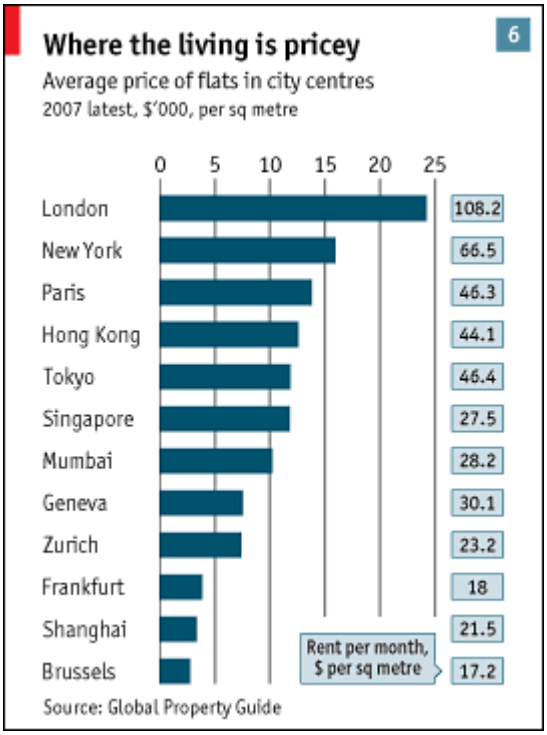
Success may come at a price, but no one seems put off



THERE is no single route to success as a financial centre. London has been at the heart of a great overseas trading network for centuries. New York rose as the gateway to the New World. Geneva and Zurich sit in a wealthy region and have benefited from favourable tax and regulatory policies. Chicago emerged as a global centre for futures and options because of its proximity to America's agricultural belt. Shanghai and Mumbai, both fledgling international hubs with big ambitions, serve vast, developing national markets. Places such as Singapore or Dubai have had to work hard to lure business to their shores. Yet for all their variety, these financial centres have certain things in common.

Saskia Sassen, a sociologist with a special interest in global cities, argues that one reason for the concentration of financial firms in a small number of centres is the social connection and information that comes from proximity with people in related fields. A second is the use of technology that (counter-intuitively) still filters a lot of apparently dispersed investment back to a few key electronic exchanges.

A third is the increasing globalisation of big corporations. As companies open new factories and national offices, their financial advisers follow. And as more banks and brokers move into financial centres, they attract related businesses such as law firms, accountancy practices and public-relations agencies. Not long ago big investment banks were represented in only a handful of cities. Zoe Cruz, co-president of Morgan Stanley, recalls that when she joined the firm in 1982 it had fewer than 3,000 employees in its main office in New York and two smaller ones in London and Tokyo. Today it has “flags in almost every country in the world” (actually, about 30).

Even though these days anyone with a laptop and a high-speed internet connection can trade financial products from anywhere, people prefer to cluster in the same old places. *Trader* magazine, a glossy publication designed for hedge-fund managers, currency traders and the like, recently named Chicago, London and New York as its top three cities for traders, though it also lists some less obvious ones in a top 20 that includes Miami and Las Vegas. The ranking was based on a range of factors, from trading infrastructure and taxes to nightlife and recreation facilities.

Quality of life is important to highly paid financiers, and successful centres such as London are changing constantly to keep delivering what it takes. Take a stroll through the narrow lanes of Spitalfields in the old East End of London and see the trendy market stalls and cafés that have arisen from the former wholesale fruit and vegetable market. On nearby Brune Street an historic building that formerly housed a soup kitchen “for the Jewish poor” is being converted into upmarket flats. The sign for Fournier Street, recalling the French Huguenots who settled here to escape religious persecution, is replicated in Bengali to cater for recent South Asian arrivals. Property prices have shot up, with ever more young financiers taking up residence here. The appeal of this traditional haven for working-class immigrants is its close proximity to the financial district, allowing financiers to walk to work.

Growing prosperity, a bigger tax haul and the cosmopolitan lifestyle of young financial professionals have injected new vitality into places like London, New York and Hong Kong. Yet there is also growing inequality, a steep rise in the cost of living and increasing pressure on middle-class families who are having to live ever farther away from city centres.

The income discrepancy between haves and have-nots in the world's financial capitals has not been this

great since America's "gilded age" in the late 19th century, says Susan Fainstein, an expert on urban issues at Harvard. The trend began in the 1980s and has become stronger, despite temporary blips such as the dotcom bust in 2001. A report on wealth inequality in Britain in July found that the gap between rich and poor is now bigger than it has been for 40 years, with the proportion of middle-class households shrinking.

"People doing ordinary jobs, like firefighters, cannot afford to live in London," says Chris Hamnett, a sociologist. The city now has a commuting zone stretching about 80 miles (129 km). Something similar is happening in Manhattan, where the price of an average property has risen above $1m.

The new wealth of nations

Not all this urban gentrification can be laid at the door of financial services, but the new rich in the world's top cities are more likely to be hedge-fund managers than industrialists. Research recently by Mr Kaplan and Mr Rauh of the University of Chicago showed that in 2004 nine times as many Wall Street executives earned over $100m as did chief executives of public companies. The top 25 hedge-fund managers earned more than the chief executives of all the companies in the Standard & Poor's 500 combined.

As the financiers' money cascades across the cities where they live and work, it transforms everything from house prices to shopping patterns. Mr Hamnett draws an analogy with a multi-tiered water fountain, with water flowing first from the financial district to smart residential neighbourhoods, then to slightly less smart areas, and so on. On the other hand, if investment bankers' bonuses dry up, so will their lavish spending.

All this calls for a delicate balancing act from political leaders. The appeal of a vibrant financial sector is clear for politicians, ranging from Michael Bloomberg, New York's mayor, a former business tycoon who counts many of the city's top financiers among his personal friends, to Ken Livingstone, London's mayor, who used to be known as "Red Ken" for his far-left stance. They all understand that capitalism can be good for a city.

Illustration by Michelle Thompson

Many in the financial elite are closely involved with their communities, raising funds for charities, supporting schools and making donations to political parties. Mr Doctoroff in New York points to public-spirited firms such as AIG, JPMorgan Chase and Merrill Lynch that have set up charitable foundations. London's financiers have also become more generous donors to charity.

Yet the recent backlash against private-equity firms in several countries illustrates the dangers of appearing to favour the financial elites, whether through tax policies or political access. Trade unions, consumer groups and politicians have railed against such perceived favouritism. Moreover, globalisation has meant that the financiers' ties to a "home town" are not as clear as they once were. Mr Doctoroff notes that despite executives' recent public-spiritedness, none is as involved in and committed to public causes in New York as David Rockefeller was decades ago.

Despite such drawbacks, most cities would kill for a thriving financial sector that produced highly paid jobs and juicy tax revenues. Big financial firms have fanned out around the globe and are not shy about telling politicians exactly what they want. Many of the things they are looking for—from good infrastructure to low taxes—are helpful for businesses of all kinds, not just financial firms. Being able to attract the right talent is critical too.

It is the mix of all these factors that has kept New York and London so far ahead of the rest. They may be shockingly expensive places to live, but top financiers clearly think they are worth it. And there are plenty of lesser financial centres that aspire to become more like them.

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Sources and acknowledgments

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European energy

Breaking up is hard to do

Sep 13th 2007 | BRUSSELS, FRANKFURT AND LONDON
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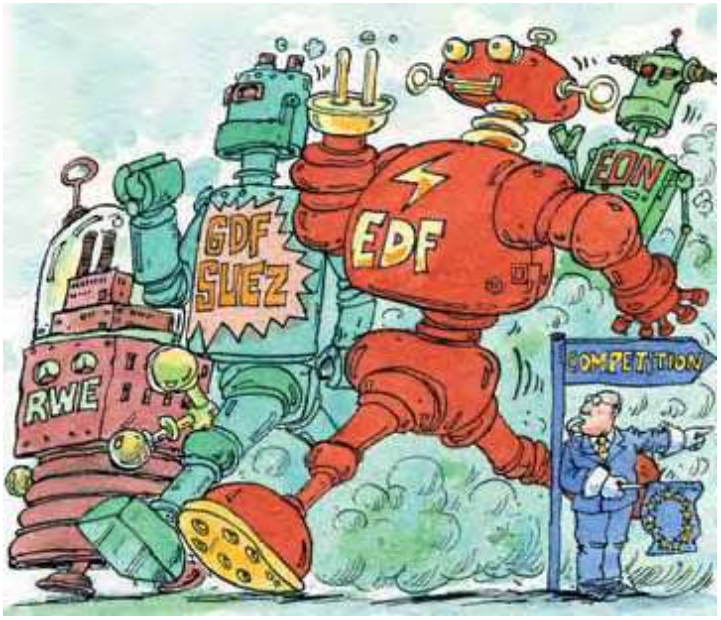
Illustration by David Simonds



Attempts to reform Europe's energy markets are losing out to protectionism

“WHAT is important is that Europe defends its own interests. It is absolutely not a question of protectionism,” said Jean-Pierre Jouyet, France's European affairs minister. He thinks the separation or “unbundling” of energy production and transmission assets, as advocated by the European Commission, would weaken the competitiveness of operators without guaranteeing lower prices to consumers. And he warned that Europe does not want a market that will be structured “in a way that punishes European operators with regard to others, and I mean in particular the big Russian operators.”

Mr Jouyet was speaking at the European Parliament a few days after the announcement of the merger of GDF and Suez, two French utilities that will together become the world's third-biggest utility. His words put an end to any hopes that the French government might compromise in the debate over the commission's plans to reform energy markets. France thinks the European Union (EU) needs vertically integrated energy giants that both provide the juice and also transmit if they are to be able to stand up to Russia's Gazprom and other big producers. France already has two giants, Electricité de France (EDF) and GDF Suez, and is planning to create a third through a link-up between Areva, the world's biggest nuclear company, Alstom, an engineering group, and Bouygues, a construction and telecoms conglomerate.

France's energy strategy is diametrically opposed to the commission's plan to make the market more competitive. After months of consultation and investigation, Andris Piebalgs, the EU energy commissioner, concluded that big vertically integrated firms such as France's EDF and GDF and Germany's E.ON and RWE are the main reason why Europe's energy market is so dysfunctional. They keep prices high, shut rivals out of their transmission networks and avoid reinvesting their profits in improving their networks because to do so would increase competition. Breaking them up, says Mr Piebalgs—seconded by Neelie Kroes, Europe's competition commissioner—would make the market more efficient and improve security of supply.

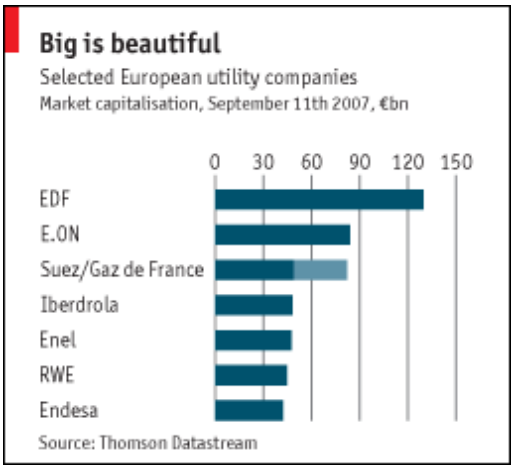
Yet when Mr Piebalgs presents a draft law on energy regulation to the commission on September 19th, he is not expected to propose anything half so radical as a compulsory dismantling. Instead he is likely to give firms the choice between “independent transmission system operation” (ITSO), which is EU jargon for full unbundling of production and transmission, and “independent system operation” (ISO), a watered-down scheme that lets companies keep the transmission networks—as long as an independent operator

manages them. Perhaps he had no choice. Not only France is stonewalling, but Germany, Austria, Bulgaria, Cyprus, Greece, Luxembourg, Latvia and Slovakia are too. These nine sent a letter to the commission in July rejecting unbundling after a group of eight other countries, led by Denmark, fired off a letter to support it. All the countries in the Danish group have already introduced ITSO, or full unbundling.

France's most powerful ally among the antis is Germany. In a recent speech Wulf Bernotat, boss of E.ON, compared the commission's pursuit of unbundling to the hunting of a mythical beast, and called for strong European energy companies. Michael Glos, Germany's economics minister, thinks unbundling is not a “cure all”.

German regulators argue that they have done a lot to reduce the oligopoly held by E.ON and RWE. Electricity and gas prices for consumers across the EU were freed on July 1st, allowing smaller firms to compete for E.ON and RWE customers. In August an association of consumer groups started a campaign to encourage Germans to switch to cheaper suppliers. The deregulation of retail prices has caused RWE to abandon a plan to increase prices. And in June the government proposed capping the price that big power companies and municipal plants can charge for delivery through their grids. The cap would be set at the price of the cheapest network.

All this, say the Germans, shows that it is possible to create a competitive market without resorting to unbundling. Yet the electricity market in Germany is far from functioning properly. The prices seen on the Leipzig electricity exchange are much higher than producers' actual cost of production. According to the commission, German companies pay €150 ($208) per megawatt hour for electricity, but businesses in neighbouring Austria pay €100.



Commercial customers in different countries are charged energy prices that vary by as much as 100% across what is supposed to be a single market. The reason, says Dieter Helm, an expert on energy policy at the University of Oxford, is that the EU started to deregulate more than ten years ago without changing the structure of the market. Britain's example shows that deregulation works only when you modify the market structure first, through measures such as unbundling. The EU has got it backwards.

The commission admits that giving countries the choice between ISO and ITSO is only second best. A conflict of interest persists within a vertically integrated company, even if the management of the network is outsourced. ISO needs Chinese walls and close regulation. Some argue that it requires the setting up of an EU energy regulator. Claude Turmes, a Green MEP, thinks ISO is a “Potemkin village” that provides only the illusion of competition, and worries that a new regulator will lack clout.

Given the choice between ISO and ITSO, many French and German politicians would prefer to do nothing. They sound a warning about Russia's energy strategy—“superbundling”. According to Colette Lewiner at Capgemini, a consultancy, Russia is seeking control over pipelines coming from former Soviet countries that have either gas, such as Turkmenistan or Kazakhstan, or a strategic position on the road to the EU. Russian firms would welcome unbundling across the EU, because they are mustard keen to buy into EU transmission networks and suppliers to tighten their grip on the EU energy market. One-quarter of EU gas comes from Russia, and this is expected to rise to 50% by 2030.

So far Europeans have kept energy largely within national borders, and as a result the cost of energy is higher and security of supply is lower, says Mr Helm. There is no European grid, no European gas storage and not much of a European energy market. Whatever the commission proposes on the September 19th, that seems unlikely to change.

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The car industry

The road ahead

Sep 13th 2007 | FRANKFURT
From The Economist print edition

The bullish mood in Frankfurt belies an uncertain future for the car giants

A CASUAL visitor to this week's sprawling motor show in Frankfurt would conclude that the global car industry is robustly self-confident as it churns out new models to fill every niche of consumer demand and forges ahead with the green technologies that will reconcile the car with the future health of the planet. The reality is different. There is little or no growth in the carmakers' oldest markets. Demand in western Europe is flat; North American sales, hit by fall-out from the collapse of subprime lending, are on the brink of recession; and Japanese sales are shrinking as the population declines.

Everybody agrees that an industry needing growth must look to emerging markets such as China, India, Russia and Brazil. Carlos Ghosn, the boss of the Renault-Nissan alliance (see article), points out that sales in those countries doubled between 1999 and 2006. Now that these emerging markets have started to matter, the established carmakers are racing to find local partners and produce vehicles that will appeal to new buyers in Asia and South America. Volkswagen (VW), a latecomer to the party, this week announced the Up!, a €6,000 ($8,300) small car for emerging markets with a rear-mounted engine that harks back to the original VW Beetle.

Another danger for the established carmakers is the rate at which they are transferring technology to joint-venture partners as the price of market access. Some of those partners are turning into formidable competitors themselves, with ambitions both in their own markets and further afield. For the moment the threat is limited. Chinese and Indian firms will struggle to meet safety and emission standards in America, Japan and the European Union. But that will not hold them up for ever.

It is not just the scramble for customers in new markets that will divide the industry into winners and losers. So will the imposition of stricter emissions standards and ever more punitive taxes on polluting vehicles. Just now the industry is trying to have it both ways. It is arguing furiously against the European Commission's goal of reducing average fleet emissions to 130 grams of CO_2 per kilometre by 2012, and the new fuel-economy rules being drawn up in America. But at the same time it is talking a green game and showing off new fuel-sipping technologies.

Several manufacturers, such as Ford Europe and VW, have introduced high-economy sub-brands across their ranges. VW's green range is called BlueMotion, and this week Ford announced a similar idea called ECOnetic. Using affordable technologies such as improved aerodynamics, various electronic tweaks and low-resistance tyres, Ford's new Focus and VW's new Polo have CO_2 emissions comparable to Toyota's Prius hybrid. The southern European producers, Renault, PSA Peugeot Citroën and Fiat, already make large numbers of small cars with efficient diesel engines. But greenery poses more of a problem for BMW, Mercedes, Audi and Porsche. They are exploring every possibility—Porsche is even making a hybrid version of its indecently rapid Cayenne SUV—but they may simply have to make smaller, less powerful cars in future.

As to which of the green technologies will dominate in the future, the mantra of most car executives is that it will vary from market to market. In Europe ever-cleaner diesels lead the way and hybrids have yet to make much headway. In America, clean-air regulations that have blocked diesel cars are due to get tighter still. “I have the gravest doubts whether diesel will ever be a solution in the US,” says Bob Lutz, vice-chairman of General Motors (GM).

Accordingly, GM plans to produce a wide range of mainstream vehicles using the E-Flex powertrain that first appeared in its Volt concept car in Detroit earlier this year. At Frankfurt GM's Opel unit showed a small diesel-electric hybrid with a battery that can be recharged from the mains to give an electric-only range of 40 miles. On longer trips, the diesel engine acts as a generator to recharge the battery, rather than driving the wheels directly. Toyota, in contrast, relies on a more complex hybrid architecture in which both the petrol engine and the electric motor can drive the wheels. Mr Lutz says he believes that

consumers will overwhelmingly prefer GM's approach. Place your bets.

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Mobile phones

From iPhone to gPhone?

Sep 13th 2007 | SAN FRANCISCO
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Silicon Valley is causing a stir in the wireless industry

JUST 74 days after launching its iPhone, Apple said this week that it had already sold 1m of the things—a milestone that its previous blockbuster product, the iPod, took almost two years to reach. Its appetite thus whetted, Apple has now cut the iPhone's price from $599 to $399 in a bold grab for the mass market. And yet, to judge by the industry's chatter, the iPhone is already old news. More excitement swirls around rumours that Google, the web-search giant that is Apple's neighbour in Silicon Valley, could enter the market with its own "gPhone". Google's boss, Eric Schmidt, has already said that the firm plans to bid for a prime slice of American wireless spectrum in a forthcoming auction, something Apple is also said to be considering. In short, both mobile operators and handset-makers could soon be confronted with two of the world's sexiest brands as direct rivals.

Publicly, Apple and Google are being diplomatic so far. The industry is a stool with three legs—network service, devices, and the software and content that goes on them—and "I don't think any player in the ecosystem trying to glue it all together will be very successful," says Dipchand Nishar, who leads Google's mobile-phone strategy. By this he may simply be conceding the obvious, which is that Google would not build hardware, even if it made the other two legs. (Previous rumours that Google would launch a low-cost personal computer proved to be unfounded.)

But Google seems to be up to something. It bought a company called Android in 2005 that specialises in mobile-phone software. It has Google Talk, a free internet-calling service. In July it bought GrandCentral Communications, a firm that gives users one single phone number for life. And it recently filed a patent application for a new mobile-payment technology.

It would certainly be tempting to tie all these bits together into a new software "platform" for mobile phones and offer it to handset-makers as an alternative to existing smart-phone operating systems such as Symbian, Palm or Microsoft's Windows Mobile. Naturally, Google's search, e-mail and document services would be tightly integrated, along with its advertising technologies, which might pave the way for mobile service that is partly or wholly subsidised by advertising.

As a strategy, this might be just different enough from Apple's to assure harmony with its ally. Mr Schmidt sits on both companies' boards, as does Arthur Levinson, the boss of Genentech, a biotech firm. Google also supplies map and video software for Apple's iPhone. It would suit neither firm to open hostilities. So Google may concentrate on software for cheaper, mass-market devices, leaving Apple to make elegant, high-end hardware.

Hardware aside, the more intriguing possibilities concern the spectrum auction. Next year America's Federal Communications Commission (FCC), the telecoms and media regulator, will sell a band of radio wavelengths that will become available in 2009 as television broadcasters migrate from analogue to digital technology.

The usual buyers for such spectrum would be America's existing telecoms operators, such as AT&T and Verizon. Their "walled garden" model does not allow consumers to choose among handsets, operators and software applications, or even to roam around the open internet. In July, however, Mr Schmidt sent a letter to the FCC in which he pledged to enter the bidding, provided the FCC forces any winner to open up the new network.

The FCC accepted some but not all of Google's advice, so the winner will have to give consumers the freedom to choose handsets and applications. Mr Schmidt declares himself happy enough and says that Google will "be a player in some form", either alone or in concert with partners. Such as Apple, perhaps?

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The internet

Not losing Facebook in China

Sep 13th 2007 | SHANGHAI
From The Economist print edition

Social-networking and video-sharing sites are booming

XIAONEI.COM does not just look like Facebook, the booming social-networking website. As well as borrowing its design, it has also lifted its strategy and transplanted it to China. It is not alone. All the big "Web 2.0" sites—those that let people share information, collaborate and link up with friends—have many Chinese knockoffs. YouTube, the video-sharing site that is now part of Google, has over 200 copycats in China, about 10% of them backed by venture capital, says Isaac Mao, an internet investor and a Chinese blogging pioneer.

And no wonder, since most Web 2.0 sites do not have official Chinese versions. So enterprising start-ups simply copy the ideas and graphics, and localise them to suit Chinese tastes. The Chinese market is now so saturated that it is much harder to raise money than it was a year ago, says Gary Wang, the boss of Tudou—a site known as the "Chinese YouTube". This is a good thing, he says, because it means investors are being much more discriminating.

The surge of interest has created some problems, however. There is not enough bandwidth or data-centre capacity to keep up with demand, says Kaiser Kuo, director for digital strategy at Ogilvy China, an advertising agency. This makes some websites painfully slow to use. Another problem is that traffic does not flow smoothly between the networks of China Telecom and China Netcom, the two fixed-line telecoms operators. Many firms deal with this by setting up "mirrors" of their sites.

Cultural compatibility is much less of a problem, given the extent to which Chinese society is built on personal connections, or *guanxi*. Online social-networking is a logical extension of such relationships, says Allison Luong of Pearl Research, an internet consultancy.

Some Chinese start-ups, such as Anothr.com and douban.net, are now seeking customers outside China with English-language websites. Others hope to do deals with foreign Web 2.0 firms. One of Mr Mao's investments is in Wealink, a Chinese site inspired by LinkedIn that has around 1.2m users. It has attracted the attention of the original LinkedIn, and the two firms have discussed a tie-up. "Who knows?" says a smiling Mr Mao. "Maybe in the future we'll see Wealink buy LinkedIn."

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Software

Liquid concrete

Sep 13th 2007 | WALLDORF, GERMANY
From The Economist print edition

As software shifts to an "on demand" model, can SAP move with the times?

WHAT'S in a name? Apparently everything—at least when it comes to a product being launched by SAP, the world's third-largest software firm, on September 19th. Although the technical details are known, the firm has kept its name secret. But whatever it is called, the launch of the new product, code-named A1S, could be a turning point for both SAP and the enterprise-software industry.

The new product is a big bet, even for a giant such as SAP, a German firm with annual revenues of €9.4 billion ($13 billion) in 2006 and around 42,000 employees. It has already invested hundreds of millions in the development of A1S, and expects to spend a further €400m ($553m) by 2009.

A1S is key to SAP's future growth, just as another new product was in the 1990s. Called R/3, it allowed medium-sized corporations to implement SAP's massive suite of enterprise-resource planning (ERP) software, which manages a firm's inner workings, from its accounts to its supply chain. Now A1S is meant to repeat the trick with even smaller or "mid-market" companies, considered the biggest opportunity in enterprise software. Henning Kagermann, SAP's chief executive, says he wants to triple the number of customers to 100,000 by 2010.

What makes A1S such a departure for SAP is that rather than running on a firm's own computers, it is delivered as a service via the web. SAP is a latecomer to this "on demand" or "software as a service" approach, but A1S is the first fully fledged ERP suite available in this way. This may signal a shift in the nascent market for on-demand software, away from single functions such as customer-relationship management (CRM), and towards integrated suites. The current market leader is salesforce.com, a CRM provider, with 35,300 customers and expected revenues of $730m this year. By contrast, the figures for NetSuite, a rival firm that provides a suite of services, were only 5,300 and $67m respectively in 2006, and the firm has yet to make a profit. (This has not stopped it from filing to go public.)

A1S is also meant to be more flexible than traditional ERP software, since it has been built in a new way. Rather than being a collection of separate applications, it is a set of dozens of building blocks that can be assembled and rearranged like Lego pieces. This approach also allows companies to adapt business processes to make them more efficient, or when markets change—something that is very hard to do in the old ERP world.

SAP's on-demand rivals claim similar flexibility. NetSuite says its suite is more customisable and flexible than SAP's. Salesforce.com is no longer just a CRM provider, but a platform on which customers and other software firms can build applications, which can then be assembled into combinations, or "mash-ups". Google, an online-search giant that also offers a set of web-based applications such as spreadsheets and word processing, is likely to go down a similar path. This week it announced a partnership with Capgemini, a technology consultancy, to encourage companies to use Google's applications.

Meanwhile SAP's old rivals, Oracle and Microsoft, are also vigorously pushing into the mid-market. So A1S will face competition on many fronts. But SAP has a reputation for good engineering in its favour. And the new on-demand suite should prove attractive to suppliers of big firms that already use SAP's ERP software, since A1S makes it easier to link up. That could bring in new customers.

A broader question is whether SAP can overcome its history. It grew up selling complicated software directly to big businesses. Now it will need to reach the much larger number of less sophisticated customers, who want simpler products. Worse, says Josh Greenbaum of EAC, a consultancy, firms may simply not believe that SAP has suddenly discovered flexibility. "People still haven't forgotten the old joke that implementing SAP is like pouring concrete into a company," he says.

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Business and society

Green made good

Sep 13th 2007
From The Economist print edition

Anita Roddick, pioneer of green capitalism, died on September 10th

THE only kind of entrepreneur who becomes famous in Britain, a nation sniffy about business people, is the flashy personality who embodies the brand. Think of the bearded Sir Richard Branson of Virgin Atlantic, grinning at his incessant photo-calls, or the foul-mouthed Michael O'Leary of Ryanair cocking a snook at stodgy old British Airways. Or Dame Anita Roddick, a true child of the 1960s, whose Body Shop cosmetics chain blended sensuousness, environmentalism, feminism and glamour with a whiff of political correctness.

She was into green capitalism long before it became mainstream. Her cosmetics were not tested on animals and her materials were mostly natural, bought directly from producers in the developing world. Yet her products were cleverly packaged and promoted to capture a premium price, while making customers feel good about their supposed ethical purity—a formula the established cosmetics firms subsequently emulated.

How it all started

To begin with, Dame Anita was not an activist or campaigner, simply a born trader who saw a business opportunity and opened her first shop in Brighton, on the English south coast, in 1976. Her bodycare products sent a refreshing message to women: nothing will make you stay young or grow more beautiful, but this stuff will make you feel better about yourself in the meantime. It tapped into a contemporary counter-culture removed from the sleek, sophisticated marketing of the beauty-product firms. By the time she sold the business last year to L'Oréal for £652m ($1.1 billion), of which she received £118m, Body Shop had 2,000 shops in 53 countries.

Many of Body Shop's younger customers were disgusted that this beacon of green and fair trade could sell out to a French multinational. But Dame Anita hoped that the Body Shop ethos would permeate L'Oréal. She believed that “businesses have the power to do good.”

In later years Dame Anita had less to do with her firm, though she kept its name in the media with her ubiquitous views on matters green and ethical. She became Britain's fourth-richest woman, financing a range of pacifist, ecological and human-rights causes, and planned to give away her remaining fortune. But her real legacy was to pioneer greenery as a marketing tool, and bring the harnessing of environmental and ethical concerns into the business mainstream, for good or ill.

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Face value

Tough Ghosn

Sep 13th 2007
From The Economist print edition

His halo has slipped. Can Carlos Ghosn, the car industry's only superstar boss, now restore his reputation?

Reuters

IT HAS been a torrid 12 months for Carlos Ghosn, the man who runs not one, but two car firms: Renault in France and Nissan in Japan. This time last year Mr Ghosn, the most admired car boss in the world, was still trying to pull off a deal that would have made General Motors (GM) the third member of his alliance. Kirk Kerkorian, a big shareholder in GM at the time and the main instigator of the negotiations, was convinced that only Mr Ghosn could rescue America's ailing automotive leviathan. But it was not to be. GM's confidence in its own recovery plan was growing, and the two sides could not agree. Mr Ghosn gave up the chase—and not much has gone right for him since.

In February Nissan issued a profit warning—its first real reverse since 1999, when it forged its alliance with Renault, which bought a 37% stake (later raised to 44%) in the much bigger but nearly bankrupt Japanese firm. Describing the setback in deliberately vivid terms as a “performance crisis” that needed to be fixed as soon as possible, Mr Ghosn also had to admit that his sales target of 4.2m vehicles in 2009 would be missed. Then at a testy shareholders' meeting in June, Mr Ghosn revealed that Nissan's profits would fall further in the first quarter, because of slow sales in North America. Renault's ageing product range, meanwhile, has led to falling sales and market share in Europe.

So is it time to write off Mr Ghosn as a gifted turnaround artist who began to believe his own publicity and over-reached himself when he took on the running of Renault as well as Nissan in 2005? And is the much-touted alliance between the two companies really superior, as he claims, to the car industry's usual approach of mergers, which often go wrong and destroy value?

In Frankfurt for the motor show this week, Mr Ghosn still radiated complete confidence in both the Renault-Nissan alliance and his own ability to get things back on track. A Brazilian of Lebanese descent who was educated in France and now speaks five languages, his manner is brusque and efficient, but with an underlying warmth. Twinkly and fresh despite his shuttling between Paris and Tokyo, he does, however, admit to mistakes.

At Nissan, forecasting errors gave managers too little time to react to shifts in demand, particularly in North America. The firm's product line-up was also unbalanced, with a deluge of new models launched within a few months, which made marketing difficult. Mr Ghosn also concedes that Nissan's senior managers may have found it hard to adjust to sharing their hyperactive chief executive with Renault, and taking on new responsibilities in his absence. “It was not as if I was a particularly relaxed or laid-back CEO,” he smiles. Mr Ghosn's appointment to the top job at Renault, in addition to running Nissan, may also have contributed to its problems. One of his first decisions was to delay the launch of two vital models, the new Twingo and Laguna, by a year. He did not think the new Twingo was stylish enough, and wanted to ensure that the quality of the new Laguna was up to the industry's highest standards.

As for the alliance, Mr Ghosn and his senior managers at Renault and Nissan are as lyrical as ever, convinced that by operating as distinct but co-operating entities the two firms have reaped great rewards, and will continue to do so. There are predictable economies of scale: joint purchasing now covers 70% of the parts bought by both companies. And each can benefit from the other's strengths. Patrick Pelata, a close ally of Mr Ghosn's who went with him to Nissan and is now back in Paris in charge of Renault's product planning, points to class-leading powertrain technology that draws on Renault's experience with diesel and Nissan's highly rated petrol engines and gearboxes.

Making the marriage work

Mr Ghosn says that the alliance enabled Renault to become a global company and taught Nissan to be much bolder. Cross-functional and cross-company teams, an approach much favoured by Mr Ghosn, are constantly on the look-out for new synergies. And there must, he says, be complete transparency and a shared sense of purpose. “You must be ambitious for the relationship, but not try to dominate it or you will pay for it afterwards,” he says. “It really is like a marriage.” And having lived in Brazil, Lebanon, France, America and Japan, Mr Ghosn regards differences between people and places as good things to learn from rather than obstacles to overcome.

Mr Ghosn is bullish about the alliance's scope to make both firms' push into fast-growing new markets smoother and less risky. Nissan is benefiting from Renault's pioneering low-cost Logan and its strength in Latin America, while Renault gains from Nissan's presence in markets such as China and Indonesia. New factories—one was announced in Morocco this month—typically build both Renault and Nissan vehicles. The alliance is also working together with Bajaj, an Indian maker of two-wheelers, to launch a $3,000 car. To meet increasingly tough environmental requirements, Renault will concentrate on its clean diesel technology, while Nissan develops hybrids. Mr Ghosn says that means the two companies can be fast followers, ready to provide whatever is wanted in whichever market.

Whether Mr Ghosn can restore his somewhat tarnished reputation will become clear in the next two years. At Renault he has “committed” to increasing sales and doubling its operating margin to 6% by 2009; at Nissan, he has committed (a favourite word) to keeping operating margins in the industry's first division, and reaching the 4.2m sales target in 2010. As for finding a partner in North America, an only slightly chastened Mr Ghosn still thinks it would be a good idea, but recognises that his “stakeholders” want him to get Renault-Nissan firing on all cylinders first. Much will depend on his ability to rekindle the sense of urgency that helped bring Nissan back from the brink eight years ago. In today's less dramatic circumstances, it will not be easy.

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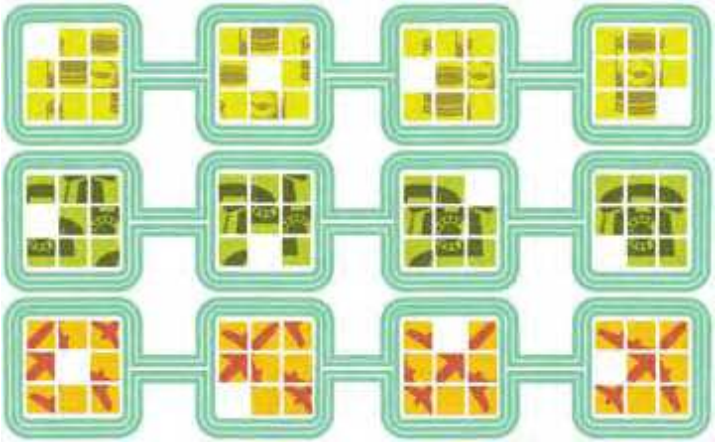
Algorithms

Business by numbers

Sep 13th 2007
From The Economist print edition

Consumers and companies increasingly depend on a hidden mathematical world

Illustration by Gillian Blease



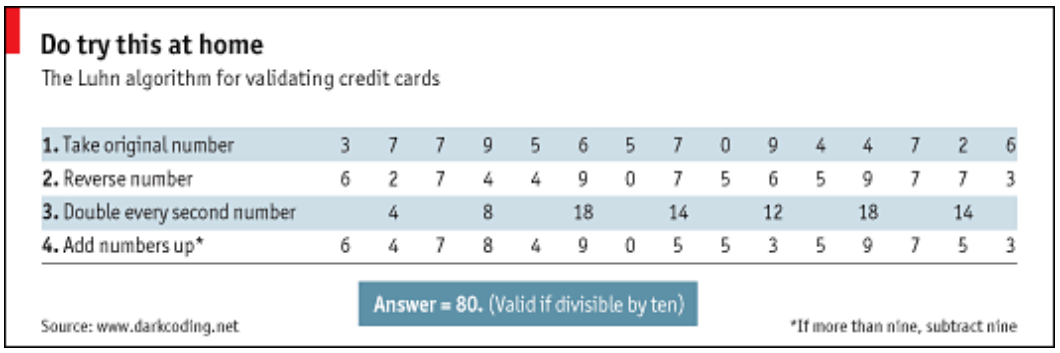
ALGORITHMS sound scary, of interest only to dome-headed mathematicians. In fact they have become the instruction manuals for a host of routine consumer transactions. Browse for a book on Amazon.com and algorithms generate recommendations for other titles to buy. Buy a copy and they help a logistics firm to decide on the best delivery route. Ring to check your order's progress and more algorithms spring into action to determine the quickest connection to and through a call-centre. From analysing credit-card transactions to deciding how to stack supermarket shelves, algorithms now underpin a large amount of everyday life.

Their pervasiveness reflects the application of novel computing power to the age-old complexities of business. “No human being can work fast enough to process all the data available at a certain scale,” says Mike Lynch, boss of Autonomy, a computing firm that uses algorithms to make sense of unstructured data. Algorithms can. As the amount of data on everything from shopping habits to media consumption increases and as customers choose more personalisation, algorithms will only become more important.

Algorithms can take many forms. At its core, an algorithm is a step-by-step method for doing a job. These can be prosaic—a recipe is an algorithm for preparing a meal—or they can be anything but: the decision-tree posters that hang on hospital walls and which help doctors work out what is wrong with a patient from his symptoms are called medical algorithms.

This formulaic style of thinking can itself be a useful tool for businesses, much like the rigour of good project-management. But computers have made algorithms far more valuable to companies. “A computer program is a written encoding of an algorithm,” explains Andrew Herbert, who runs Microsoft Research in Cambridge, Britain. The speed and processing power of computers mean that algorithms can execute tasks with blinding speed using vast amounts of data.

Some of these tasks are more mechanistic than others. For instance, people often make mistakes when they key in their credit-card numbers online. With millions of transactions being processed at a time, a rapid way to weed out invalid numbers helps to keep processing times down. Enter the Luhn algorithm (see below), named after its inventor, Hans Luhn, an IBM researcher. The numbers on a credit card identify the card type, the issuer and the user's account number. The last number of all is set to ensure that the Luhn algorithm produces a figure divisible by ten. If it is, the card number has been properly entered and the processing can go ahead.



Do try this at home

The Luhn algorithm for validating credit cards

1. Take original number	3	7	7	9	5	6	5	7	0	9	4	4	7	2	6
2. Reverse number	6	2	7	4	4	9	0	7	5	6	5	9	7	7	3
3. Double every second number		4		8		18		14		12		18		14	
4. Add numbers up*	6	4	7	8	4	9	0	5	5	3	5	9	7	5	3

Answer = 80. (Valid if divisible by ten)

Source: www.darkcoding.net

*If more than nine, subtract nine

The Luhn algorithm performs a simple calculation. But the real power of algorithms emerges when they are put to work on much more complex problems. As far as most businesses are concerned, these problems typically fall into two types: improving various processes, such as how a network is configured and a supply chain is run, or analysing data on things such as customer spending.

UPS uses algorithms to help deliver the millions of packages that pass through its transportation network every day in the most efficient way possible. The simplest routes are easy to draw up. If a driver has only three destinations to visit, he can take only six possible routes. But the number of possible routes explodes as the destinations increase. There are more than 15 trillion, trillion possible routes to take on a journey with just 25 drop-off points—and an average day for a UPS driver in America involves 150 destinations. The picture is further complicated by constraints such as specified drop-off and pick-up times for drivers or runway lengths and noise restrictions for aircraft. “Algorithms provide benefits when the choices are so great that they are impossible to process in your head,” says UPS's Jack Levis.

Go here, go there

Solving this “travelling-salesman problem” means a lot to UPS. For its fleet of aircraft in America, the company uses an algorithm called VOLCANO (which stands for Volume, Location and Aircraft Network Optimiser). Developed jointly with the Massachusetts Institute of Technology (MIT), it is used by three different planning groups within UPS—one to plan schedules for the following four to six months, one to work out what kind of facilities and aircraft might be needed over the next two to ten years, and one to plan for the peak season between Thanksgiving and Christmas. Getting the scheduling wrong imposes a heavy cost: flying half-empty planes or leasing extra aircraft is an expensive business. UPS reckons that VOLCANO has saved the company tens of millions of dollars since its introduction in 2000.

Logistics firms are far from the only ones working on “optimisation” algorithms. Telecoms operators use algorithms to establish the quickest connections for phone calls through their networks or to retrieve web pages speedily from the internet. Manufacturers and retailers use them to fine tune their supply chains. Call centres decide where to place an incoming call, based on things such as the customer's location, the length of queues that operators have to deal with and the reason for people calling.

Jeff Gordon, who looks after innovation for Convergys, a call-centre operator, says that the efficiency of algorithms is as crucial to his industry as the quality of call agents: “If you get the algorithm wrong and put customers into the wrong hands you degrade the experience. No one likes being handed off to someone else.”

The most powerful algorithms are those that cope with continual changes (see article). The delivery schedules for online grocers have huge “feedback loops” in which the delivery times chosen by customers affect the routes that vans take, which in turn affects the choice of delivery slots made available to customers. UPS is working on a real-time algorithm for its drivers that can recalibrate the order of deliveries on the fly, in much the same way that satellite-navigation systems in cars adjust themselves if a driver chooses to ignore a suggested route.

In the world of the internet, operators are looking at ways of marrying up the algorithms that find the shortest path through a network and those that control the speed with which information flows. At the moment, the routing algorithm does not talk to the flow-control algorithm, which means paths do not change even when there is congestion. According to Marc Wennink, a researcher at Britain's BT, combining the algorithms would mean that tasks such as downloading files could become much more resilient to network disruption. It would also allow BT to make better use of its existing network capacity.

Airports also have a keen interest in dynamic algorithms. Passengers at London's Heathrow and other

congested airports often sit in a long queue of planes waiting near the runway to depart. Delays happen because air-traffic controllers need to leave a safety margin between aircraft as they take off. This margin depends on the size and speed of an aircraft, and re-ordering the queue can minimise the delay before all the planes get into the air (mathematicians call this the departure problem). Air-traffic controllers have always reordered planes in the departure queue manually, but researchers are working on algorithms that would be more efficient.

Just as optimisation algorithms come in handy when people are swamped by vast numbers of permutations, so statistical algorithms help firms to grapple with complex datasets. Dunnhumby, a data-analysis firm, uses algorithms to crunch data on customer behaviour for a number of clients. Its best-known customer (and majority-owner) is Tesco, a British supermarket with a Clubcard loyalty-card scheme that generates a mind-numbing flow of data on the purchases of 13m members across 55,000 product lines. To make sense of it all, Dunnhumby's analysts cooked up an algorithm called the rolling ball.

It works by assigning attributes to each of the products on Tesco's shelves. These range from easy-to-cook to value-for-money, from adventurous to fresh. In order to give ratings for every dimension of a product, the rolling-ball algorithm starts at the extremes: ostrich burgers, say, would count as very adventurous. The algorithm then trawls through Tesco's purchasing data to see what other products (staples such as milk and bread aside) tend to wind up in the same shopping baskets as ostrich burgers do. Products that are strongly associated will score more highly on the adventurousness scale. As the associations between products become progressively weaker on one dimension, they start to get stronger on another. The ball has rolled from one attribute to another. With every product categorised and graded across every attribute, Dunnhumby is able to segment and cluster Tesco's customers based on what they buy.

Where to put the biscuits

The rolling-ball algorithm is in its fourth version. Refinements occur every year or two, to add new attributes or to tweak the maths. All these data then feed into a variety of decisions, such as the ranges to put into each store and which products should sit next to each other on the shelves. “All this sophisticated data analysis and it comes down to where you put the biscuits,” laments Martin Hayward, director of consumer strategy at Dunnhumby.

Fraud detection has a touch more glamour to it. SPSS, another data-analysis firm, uses algorithms to scrutinise customer data and to build propensity scores that predict how people will behave. One of its clients is ClearCommerce, which provides payment-processing services to online merchants. SPSS helped ClearCommerce to build a system that looks at a customer's past transactions and learns what hints at fraud—it might be the amount of money being spent, the shipping details and the time of day, and so on. Transactions then get a fraud-propensity score based on these characteristics; merchants decide which scores should ring alarm bells and how to respond.

Algorithms are most commonly associated with internet-search engines. “The tussle between MSN, Google and Yahoo! is about whose algorithm produces the best results to a query,” observes Microsoft's Mr Herbert. Ask.com, another search engine, has even tried to popularise the term in an advertising campaign. Few other types of companies are so obviously dependent on algorithms for success, but the role that they play is rising in importance for two reasons.

The first is the sheer amount of data that is now available to companies. The information floodwaters are rising everywhere. Smart meters give utility firms data on consumption patterns inside households. Digital media will make it easier for firms such as Dunnhumby to see how what people read online and watch on television affects what they buy.

Online shopping means that internet merchants now know what customers are browsing as well as buying. Search engines are mining their own information on the relationship between queries and clickthroughs so as to improve their ranking algorithms. “For the first time in business history there is more information than many organisations' capacity to deal with it,” says Dunnhumby's Mr Hayward. Algorithms are a way to cope.

The second reason why algorithms are becoming more important is that companies inevitably want to use all this new data to do more complicated things. In particular, they want to respond to each customer in a personalised way. Tesco does this by using its analysis to tailor direct-marketing offers to each Clubcard member. As well as segmenting its customers on how they live, the data also enable the supermarket

rapidly to spot shifts in their consumption patterns (caused by children going to university, say). Tesco's response rates to such targeted marketing stands at 10-20%, against an industry average of only around 1%.

Convergys wants to bring more real-time data to the operation of call-centres. Mr Gordon gives the example of a customer who calls an electricity utility from an area that has suffered a power failure and, because of where they are speaking from, is automatically put through to an operator who can deal with his queries. Such algorithms help firms to tease simplicity from complexity.

Algorithms are not for everyone. Some companies will always generate more data than others, of course: retailers, utilities and telecoms firms process many more transactions than house insurers, whose deals tend to happen once a year. Some will also be more focused than others on how algorithms can shave costs or maximise capacity. Firms that enjoy high margins and strong demand are going to be less worried about the efficiency of their supply chains, says Hau Lee, of Stanford Graduate School of Business.

Rocket science for non-boffins

What is more, lots of things have to fall into place for algorithms to work. They tend to be highly complex: it is not easy to find people with the right skills to develop and refine them. The systems within which the algorithms run—the user interface—need to be intuitive to non-boffins. “This is rocket science but you don't have to be a rocket scientist to use it,” says Jack Noonan, boss of SPSS. The inputs have to be right. One UPS planning model routed all the packages in the system through Iowa, which perplexed everyone until they found an error in the data that made it appear to be free to send packages via Iowa. The algorithm was right, in other words, but the data were wrong. Mr Noonan says that SPSS's “secret sauce” lies in its ability to deal with missing or unreliable data, rather than the algorithms themselves.

Above all, human judgment still has a role—a point perhaps reinforced by the recent performance of algorithmically driven quantitative funds in the financial markets. In fraud detection, for example, algorithms can eliminate the majority of transactions that are above suspicion but a human is still best placed to analyse the dodgy ones. Dunnhumby is trying to overlay attitudinal research on top of purchasing data to understand why people buy things as well as what they buy. Even so, Autonomy's Mr Lynch is convinced that algorithms are on the march. Algorithms process data to arrive at an answer. The more data they can process the more accurate the answer. For that reason, he says, “they are bound to take over the world”.

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Big sums

Of greed and ants

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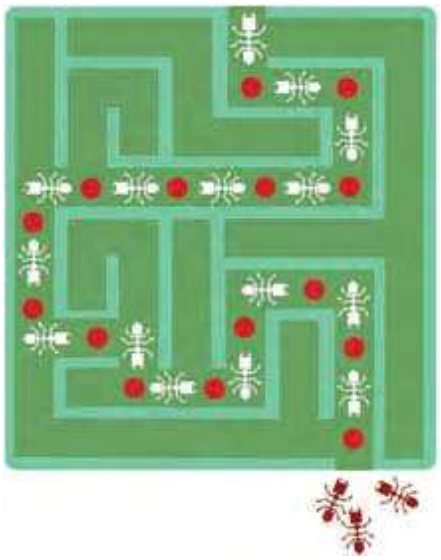
Nature could help design even smarter algorithms

Illustration by Gillian Blease



OF ALL the pleasures offered by the algorithmic world, the colourful names of its inhabitants rank pretty highly. Bubble sort is a sorting algorithm that swaps items in a list if they are in the wrong order, enabling smaller items to bubble to the top. The bully algorithm selects a lead computer in distributed computing processes. Even algorithms named after their parents can amuse: Blum Blum Shub may sound like the title of a Motown record but is actually the name of a number-generating algorithm.

Greedy algorithms take a shoot-from-the-hip approach, making the choice that gives the best possible outcome at any particular moment. To solve the travelling-salesman problem, a greedy algorithm would simply instruct a driver to go to the nearest unvisited destination. To decide where to place mobile-phone masts for the widest possible coverage, the algorithm would put the next mast where it covers the maximum amount of uncovered space.

Greedy algorithms can be very effective. They are used in network routing to find the shortest possible path to a destination, for example. But greed also makes them short-sighted, says Erik Demaine, a computer-science professor at MIT. Greedy algorithms make bad chess-players, for example, taking an opponent's pawn for an immediate but slight advantage even if it means losing a queen as a result.

For the same reason algorithms are not very good at coping with fast-changing environments, such as transport networks that are prone to disruption. But they are getting better. The mass of data combined with the power of computers now makes it possible to surpass human experts in some fields, says Ian Ayres, a professor at Yale University, in a new book, “Super Crunchers” (see article).

Thorsten Schnier, a researcher at Cercia, an offshoot of the computer science department at Britain's University of Birmingham, believes that algorithms based on biological systems offer great potential. Ants, for instance, drop pheromones as they search for food to bring back to the colony. Other ants follow these trails and converge on those where pheromones are the strongest (they are topped up more frequently on shorter routes). These principles can be mimicked in ant-colony algorithms that send virtual ants into a simulated network, randomly at first but then with instructions to follow the strongest pheromone trail. If it is blocked by some kind of disruption, the old trail dries up and the ants scurry to the next-best route.

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Currencies

Another shoe to drop

Sep 13th 2007 | LONDON AND WASHINGTON, DC
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Illustration by Satoshi Kambayashi

It is how steadily the dollar is falling that counts, not how swiftly

FOR several years, the darkest scenarios for the world economy have involved a dollar crash. The script was simple. America's dependence on foreign capital was a dangerous vulnerability. At some point foreign investors would refuse to pile up ever more dollar assets. If investors were spooked, say by a crisis in American financial markets, they might ditch dollars fast. The greenback would plunge. A tumbling currency would prevent the Fed from cutting interest rates, deepening and spreading the economic pain.

Well, the financial shock has hit, with investors shunning whole swathes of the asset-backed market and nervous about all manner of financial wizardry at which America excelled. But where is the stampede out of dollars? The greenback has fallen, to be sure, particularly since it has become clear that the Federal Reserve is likely to cut interest rates on September 18th, and particularly against the yen and the euro—the dollar hit an all-time low of $1.39 per euro on September 12th.

But the decline, so far, has hardly been a panicked rout. Although the dollar has plumbed historical depths against an index of major currencies, it has fallen by less than 1.5% since the financial turmoil hit in early August. Measured against a broader group of currencies that includes all America's main trading partners, the dollar is little changed from where it was before August's tumult began.

As the first signs of trouble emerged, the dollar even rose. Far from fleeing greenbacks as the panic spread in mid-August, investors initially flocked to them. To some analysts this confirmed the dollar's status as a haven in troubled times. More likely, it was the consequence of unwinding leveraged bets elsewhere. Dollar short positions were cut sharply in August as investors reduced risk across the board. David Woo, a currency strategist at Barclays Capital, says the dollar got a temporary lift as investors unwound bets that the euro would rise relative to the yen. Brad Setser, an analyst at RGE Monitor, argues that European banks caught with asset-backed commercial paper may have been buying dollars for fear of being unable to roll over the short-term debt.

Whatever the reason, the dollar's initial buoyancy did not last. In recent weeks the greenback has slowly fallen and the likely path of interest rates suggests there is more weakness to come. Figures released on September 7th showed that America's economy lost 4,000 jobs in August, rather than creating the 100,000 odd that forecasters had expected. Worse, the jobs figures for June and July were revised down dramatically. These gloomy statistics suggested that the economy was weakening well before the credit turmoil hit, and all but sealed the case for a cut in short-term interest rates on September 18th, certainly of a quarter point, perhaps by as much as half a percentage point.

A series of speeches by Fed officials this week did little to dispel the presumption of lower rates. With Jean-Claude Trichet, president of the European Central Bank, hinting strongly that euro-zone interest rates might rise again this year, it is no surprise that the dollar has hit new lows against the euro.

Its path against the yen is harder to foresee. Japan's economy, too, seems to be in a spot of bother, with output falling in the second quarter according to figures released on September 10th. Though Japan's statistics are notoriously volatile, these figures make it much less likely that the Bank of Japan will raise interest rates in a hurry. That suggests the carry-trade (selling borrowed yen to invest elsewhere) will remain attractive, limiting the yen's rise.

The doomsday scenario

For true dollar pessimists, these cyclical considerations are only part of the story. Far more important, they argue, is the risk that the private investors and central banks that have been funding America's gaping current-account deficit become permanently less keen on dollar assets.

Ken Rogoff, an economist at Harvard University, and a dollar bear, argues that America's image as a great financial centre has been tarnished by the subprime mess. The “mystique” that has allowed America to borrow lavishly and cheaply has suffered a blow. The result, he argues, must be a lower dollar and higher interest rates in America relative to the rest of the world.

Indeed, the complex structured-debt products that investors now shun have been an important source of financing for America's current-account deficit. In 2006 foreign investors, on net, bought some $400 billion of corporate-issued debt (including mortgage-backed securities not guaranteed by the government-sponsored housing giants Fannie Mae and Freddie Mac). That is the equivalent of around half the current-account deficit.

It is hard to know what share of this debt was asset-backed, let alone mortgage-backed. A survey by the Treasury department in mid-2006 suggests some 30% of the stock of corporate debt held by foreigners was (then) in the form of asset-backed securities and a little over half of that was mortgage-related. Those numbers are big enough that foreign flight from the mortgage-backed market, if not countered by eager buying of other types of American assets, could cause trouble for the dollar.

The lesson of the past few weeks, however, is that this is unlikely to happen all of a sudden. And if private investors fret, central banks may well pick up the slack. The latest statistics from the Federal Reserve Bank of New York suggest that central banks have been reducing their holdings of dollars since August. But that may be an aberration since several central banks, such as Russia's, had to dip into their reserves to support their own currencies. Mr Setser points out that over the past few years central banks have consistently acted as a buffer to falling private demand for dollar assets. If private demand for dollars dwindles too fast, he expects the same thing to happen again.

China, in particular, has little to gain from a dollar crash. With domestic inflation now at a ten-year high, China's politicians may be willing to let the yuan rise somewhat faster against the dollar. But they are unlikely to add to a rout, not least because that would make their exports much less competitive in America.

Another argument against a sudden crash is that the dollar is already quite cheap. In real effective terms, it has slowly fallen by some 20% since its recent peak in 2002. That decline is already helping to shrink America's external deficit. Monthly trade figures for July showed exports growing at a 14% annual rate, whereas imports grew by 5%. This differential, notes Jim O'Neill of Goldman Sachs, is the biggest in years. Add in the probability of sharply slower domestic demand in America, and the current-account deficit could shrink a fair bit over the coming months. A smaller need for foreign funds would itself put a floor under the dollar.

All told, the doom-mongers' script may play out in reverse. Instead of a financial crisis prompting a dollar crash, it may accelerate the unwinding of the imbalances that had the worrywarts so unnerved in the first place.

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Gold

The bears' lair

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Riddles about the gold price explained

GOLD seems like a good buy when everything else feels too risky. Most people expect the stuff to act as a store of value over the long term. And even if it goes down, gold can still be hammered into pretty shapes and worn around the neck to impress the neighbours, something that cannot be said of depreciating share certificates.

Gold has done well recently, passing the magic mark of $700 per troy ounce last week. But it has not been much of a hedge. When the markets started wobbling this summer it went down; when they picked up it headed up. What has been going on?

According to an analysis by Goldman Sachs, the yellow stuff has not been a reliable hedge against either risk or inflation. Its long correlation with the oil price has broken down recently because of supply constraints in the oil market. Nor does it behave much like other metals. If it did, gold might be even higher than it is. Lead has easily outperformed gold over the past two years, which might be some comfort to alchemists staring at pools of molten metal that stubbornly refuse to transmute.

A better way to think of gold may be as a currency that moves in the opposite direction to the dollar. As the greenback weakens, Goldman expects the price of gold to move to $725 per troy ounce over the next year or so. If interest rates start falling, gold, which offers no yield, may become more attractive still.

That would be a neat trick for an element that has already more than doubled in price since its low in 1999. Then, central banks were selling reserves indiscriminately, pushing the price down. They soon realised that this was not clever and got together to hammer out an agreement to limit central-bank sales to 400 tonnes a year. That amount has since increased by 100 tonnes, but the agreement holds until 2009.

Meanwhile new sources of demand have appeared. Central banks in the Middle East and Russia are building their own gold reserves. Gold bugs are watching to see if the Chinese central bank does the same, according to Trevor Steel of Baker Steel, a fund manager. Gold exchange-traded funds like StreetTRACKS have created an easy way for investors to get into the metal without having to buy mining shares. And demand for gold jewellery goes up as people get richer, particularly in India, the world's largest consumer of gold for adornment. The wedding season, which comes after the monsoon, is just around the corner. Lots of shiny things will be expected as part of the dowry.

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Commercial paper

Unscrambling the eggs

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Lessons from Canada suggest it is important to buy time

Get article background

DAVID DODGE had hoped to end his term as governor of the Bank of Canada next January after seven years without a banking crisis. But in August Canadian banks and a score of unregulated money managers were hit by fallout from America's mortgage crisis. Any thoughts Mr Dodge might have had of gently bowing out have long gone, and his last few months are likely to be spent doing the financial equivalent of unscrambling eggs. “You are dealing with massive numbers of credits,” he remarked wearily this week. “It's a very messy job.”

The Canadian's experience with asset-backed commercial paper (ABCP), a global market at the heart of the short-term funding squeeze in the world's banks, contains an uncomfortable message for banks elsewhere: because the problems may take months to fix, it is vital to buy time.

Canadian banks have had it easier than most. Thanks to a quirk in ratings in Canada, the banks argued that they did not have to offer backstop lending facilities to a number of ABCP “conduits” that ran out of funding in August, when confidence collapsed in the American mortgage assets that back them. Instead, the banks and the non-bank conduits negotiated a 60-day standstill—set to run up to the end of the current reporting period.

In that time, everyone is supposed to swap commercial paper, which is short-term and hard to refinance, for longer-term funding that matches the maturities of the collateral backing them. But Mr Dodge thinks it could take several months to sort out parts of the ABCP mess, mostly because of the unique nature of each conduit and the complex opacity of the assets within them. “Every one of these conduits is different. Some are very engineered and highly leveraged,” he says. “In the end, the conduits will have to be taken apart.”

The logjam has gummed up much of the C$115 billion ($110 billion) ABCP market in Canada. According to Moody's, a rating agency, it is costing around half-a-percentage point more to roll over such commercial paper than it did before the crisis. Mr Dodge says these increases force banks to drive up their charges for retail and commercial borrowers, which tightens monetary conditions.

Like other central banks, the Bank of Canada has a standing offer of emergency liquidity—but banks have balked at the stigma of accepting it. As order has gradually returned to its overnight-lending market, it has narrowed the collateral that it will accept in exchange for providing liquidity. On September 12th Mervyn King, Mr Dodge's counterpart at the Bank of England, also appeared sceptical of the merits of accepting a broad array of assets as collateral, unless the situation gets much worse. “Unless [such injections of liquidity] were made available at an appropriate penalty rate, they would encourage in future the risk-taking that has led us to where we are,” he said in an unscheduled statement to a parliamentary committee.

Like Mr King, Mr Dodge is fearful of moral hazard. Banks should suffer for their mistakes, he says, though not so much that the system becomes insolvent.

He acknowledged that the Bank of Canada may itself have played a role in stoking the excesses by not raising interest rates enough. “One can see in retrospect that we should have been driving those rates harder than we did, because in reality credit conditions were being eased by increased securitisation and movement of stuff off balance [sheet],” he says. That is an admission that most officials would make only when they are safely in retirement. If the failure to tighten was an error, it was surely one committed by many other central banks besides Canada's.

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Buttonwood

The profits puzzle

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American corporate profits may be heading for trouble

THE profits of American companies are strong. Morgan Stanley estimates the operating earnings of companies in the S&P 500 index will have grown at an annual rate of 9.4% in the second quarter, and by 8.5% over the year as a whole.

Or perhaps one should say that the profits of American companies are weak. The Bureau of Economic Analysis publishes earnings data from the national accounts. On that basis, domestic profits were lower in the second quarter than they were in the same period of 2006.

To be fair, these numbers do not compare like with like. Besides encompassing most American companies, the national-accounts data exclude profits earned overseas, which have been buoyed by a strong global economy and a weak dollar.

Nevertheless, the last time a gap opened up between the reported and national-accounts figures was in the late 1990s. Profits peaked as a percentage of national output in 1997. But companies reported bumper profit increases for the next three years, right up until the pricking of the dotcom bubble. Some turned out to be because of creative accounting.

Solving this conundrum is crucial for determining the prospects for shares. Optimists cite the relatively modest ratio of share prices to forecast profits as a reason for buying equities. That assumes the strength of profits will last. But, according to Chris Watling of Longview Economics, a consultancy, profits now comprise the highest share of American output since the 1960s. If profits revert to the mean, a pillar of the stockmarket will be removed.

Why might profits fall? One obvious reason is the logic of capitalism. If profits are high, more businesses will be created and existing businesses will invest more capital. That will increase competition and drive down returns.

This will not happen immediately. Peter Oppenheimer, a strategist at Goldman Sachs, points out that high returns on capital were sustained for decades in the past. Nevertheless, the dice seem to have been particularly loaded in favour of the corporate sector in recent years. Gerard Minack, a Morgan Stanley strategist, says American earnings per share are now 75% above the long-term trend, the biggest divergence recorded in the past 90 years.

Most explanations for the recent strength of corporate profits have centred on the effects of globalisation; in particular, the impact of Asian workers on labour costs. But there is another possibility; the influence of the financial sector. According to Mr Watling, the sector now contributes around 27% of the profits made by companies in the S&P 500 index, up from 19% in 1996. He reckons financial companies are responsible for a third of all of the growth in American quoted-company profits over the past decade. And Smithers & Co, an economic consultancy, says the downturn in the national-accounts profits over the last year would have been worse if not for the financial sector.

But financial profits are heavily dependent on the state of the markets. This is clearly so for fund-management firms, whose revenues are directly tied to them. The trading desks of the big banks also do better when markets are rising than when they are falling. But the chief influence is the volume of transactions, because of the fee income banks earn from arranging, underwriting and advising on deals.

In a way, therefore, the market has pulled itself up by its own bootstraps. Investors are confident about the prospects for equities because of the strength of profits. But a good deal of that profit strength is down to the financial sector, which derives much of its profits from the market.

That could be a worry, given the recent market wobbles. At the very least, there is going to be a hiatus, as lenders adjust their criteria for assessing borrowers. Defaults seem likely to rise, as some borrowers are dependent on rolling over their loans. In America the downturn in house prices may affect consumer confidence, causing a decline in other forms of lending, as well as mortgages. None of this will be good for financial profits.

As economies become more sophisticated, one would expect the financial sector to play a bigger role. In trade terms, Europe and America have a greater comparative advantage in managing money than in making things. Nevertheless, conditions for the financiers have been extremely benign over the past 25 years, thanks to the combination of rising asset prices, falling interest rates and shallow recessions. That good luck may be changing already.

Most people feel disconnected from the lives of Wall Street bankers. But if times get tough for them, they will get tough for everyone else too.

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Bank investors

Fundamentalism

Sep 13th 2007
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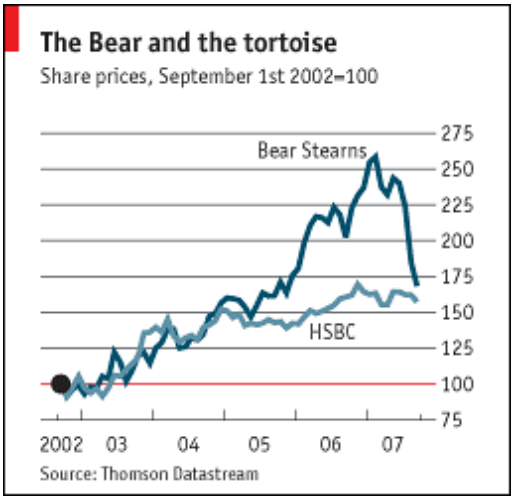
Two seasoned investors focus on the basics



UNTIL the summer, investing seemed rather easy. Money was cheap, markets frothy. Things look much less simple now, which is why two high-profile investments in the wobbliest sector of all, banking, are under close scrutiny.

By far the bigger financial bet has been made by Joe Lewis, a publicity-shy British billionaire, who disclosed on September 10th that he had amassed a 7% stake in Bear Stearns, an American investment bank that has been hit especially hard by subprime woes. Mr Lewis, who made his fortune on the currency markets and whose eclectic investment portfolio includes country clubs, football teams and restaurant brands, spent $860m between August 6th and September 7th quietly building a stake that makes him Bear's largest shareholder.

The move appears to be a straight, if massive, punt that Bear's share price has fallen too far. The bank's shares have been pummelled since the start of the year, dropping by more than 30%. Bear is more exposed than its peers to a slowdown in fixed-income markets but its shares are now trading at an invitingly small premium to book value. Some hope that Bear will still ensnare an institutional investor but stake-building on this scale by someone of Mr Lewis's pedigree is a valuable boost to confidence. Bear is due to report its third-quarter earnings on September 20th: it will be clearer then just how sharp Mr Lewis's trading instincts are.

Taking an $860m position in an investment bank in the middle of a credit crunch is certainly gutsy. But so is the decision by Knight Vinke, an asset-management firm run by Eric Knight, to launch an activist campaign against HSBC, the world's fourth-largest bank. Before the summer, activists could take advantage of cheap debt and an endless supply of private-equity buyers to push for buybacks, asset disposals and all manner of other changes. No longer. What is more, HSBC's spread of businesses and retail deposits, both of which are under scrutiny by Knight Vinke, appear more defensible in a credit squeeze.

Knight Vinke will not easily be brushed aside, however. It has a history of patient interventions at hulking companies such as Royal Dutch Shell, an oil firm, and Suez, a utilities group. By asking for a review of HSBC's overall strategy, underpinned by some bruising analysis of the bank's past performance, the firm is settling in for a siege. Its backers include long-sighted pension funds. According to Glen Suarez, director of investments at Knight Vinke, the bank needs to focus its capital and management on the areas where it has an edge, such as private banking and retail financial services in emerging markets. For bank bosses as well as their investors, hard times call for hard choices.

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Bank mergers

Three's company

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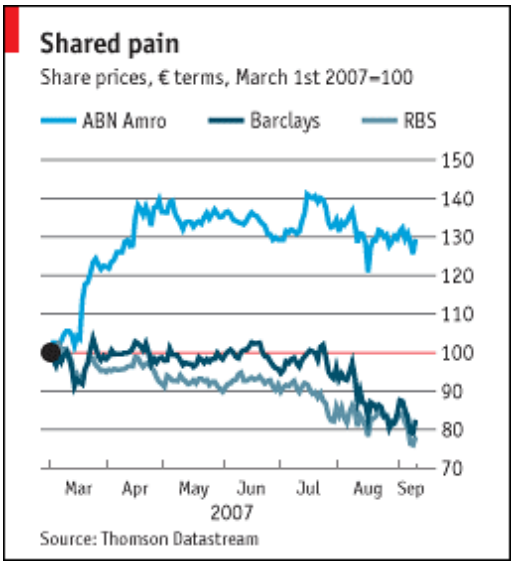
A trio of European banks is odds on to beat Barclays for control of ABN Amro

THE fight to win control of ABN AMRO, a big Dutch bank, is reaching its crunch-point. A saga that began in March, when Barclays outlined its plans to merge with ABN AMRO, will probably end in victory for a rival consortium made up of Royal Bank of Scotland (RBS), Spain's Banco Santander and Fortis, a Belgian-Dutch group. The offer periods do not expire until next month but the identity of the winner should become clear well before then.

For ABN AMRO shareholders, the choice has long looked simple. The consortium's cash-rich offer is much more generous than the equity-heavy Barclays offer, which has been dragged down by falls in the British bank's share price. On September 12th the consortium's bid valued ABN AMRO at roughly €38 ($53) per share, Barclays' bid some €6 per share lower. Even Bob Diamond, Barclays' president, acknowledged on September 10th that on price alone, the RBS-led trio is in the box seat. Why then has ABN AMRO's own share price continued to hover well below the consortium's offer value?

The credit crunch will have led to some selling of ABN AMRO shares, creating downward pressure. But the market has also been pricing in two sources of uncertainty about the consortium's bid: whether Dutch regulators, expected to rule on September 17th, will nod the bid through; and whether the consortium itself still has the stomach to do a deal.



That doubt exists primarily because of the impact of market turbulence on all the bidders (see chart). Barclays' bid suffers because the offer price has fallen in line with the bank's share price. The silver lining (and the reason why its shareholders are expected to approve the bid at a meeting on September 14th) is that Barclays is, in effect, hedged against market movements. Not so the consortium, whose members pledged to raise cash to finance most of its €71 billion deal.

Barclays' advisers helpfully point out that raising money is much harder today than it used to be. They add that RBS, which plans to snap up the wholesale bits of ABN AMRO that are most exposed to market jitters, cannot afford to let its capital ratios fall too far. Rumours swirl that the consortium may even pull the plug voluntarily, if only to bid again at a lower price. The offer contains an escape route called the Material Adverse Change (MAC) clause, a name that describes events this summer rather well.

Yet the speculation looks flimsy. Although conditions are tougher than they were, much of the financing is underwritten. Fortis, the consortium member with the most fund-raising to do, should be able to tap its shareholders for much of the money it needs. Santander is sounding out retail investors about a €5 billion convertible bond issue. RBS, where the core capital ratio is expected to fall below 5% after the deal, should recover fairly quickly. The consortium underlined its commitment to the deal by hoovering up ABN AMRO shares on the open market last month. Invoking the MAC clause would not just expose it to potential litigation by ABN AMRO shareholders, it would also make a nonsense of the consortium's talk about valuing the bank's assets for the long term.

Events could move fast. If the regulator does not object to the bid, the ABN AMRO board may swing behind the consortium's offer when it holds an extraordinary shareholders' meeting on September 20th. Even if the price looks rich, victory would be sweet for the consortium, and for Sir Fred Goodwin, the audacious boss of RBS, in particular. But John Varley, the chief executive of Barclays, would be able to point to stronger ties with sovereign investors in China and Singapore, both of which bought stakes in the British bank in July, as long-term benefits of the campaign.

A consortium win may galvanise others to follow its lead. ABN AMRO will be carved up if the trio wins, with Santander getting Banco Real in Brazil and Antonveneta in Italy, Fortis taking charge of ABN AMRO's commercial and retail businesses in the Netherlands and RBS grabbing the bank's global wholesale arm, among other things. Alliances have their drawbacks: agreeing on how to split some of ABN AMRO's clients will not be easy. But according to Arturo de Frias, an analyst at Dresdner Kleinwort, a consortium approach means that bigger targets can be chased and that partnerships can be tailored to maximise benefits. Three heads, it seems, are better than one.

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China's stock exchanges

Selling out?

Sep 13th 2007 | HONG KONG
From The Economist print edition

The independent spirit that has inspired Hong Kong is at risk

Get article background

HONG KONG saw itself as a bit of a financial pioneer when in 2000 it sold shares in its combined stock exchange and clearing house to the public. Why then, when so many other exchanges have since copied its approach, has it sought to turn the clock back? On September 7th the government announced it had bought back a stake of almost 6% in the exchange. That is now worth more than $1.5 billion.

That question was allowed to fester for days before John Tsang, the financial secretary, acknowledged on September 12th what had been widely suspected. He said it was a prelude to what he hoped would be closer ties with stock exchanges on the mainland and might eventually lead to share swaps with one or both of the mainland exchanges.

AFP

Calling mainland China for orders

The very idea of such a large payment from the public purse has touched a raw nerve in Hong Kong. It pits the city's trumpeted belief in laissez-faire policies against the reality of government intervention in what should clearly be the most market-oriented aspect of any economy—a financial exchange.

Already, the government held substantial sway over the exchange's fate, including the right to appoint a majority of its directors and to vet shareholdings of more than 5%. The exchange's chairman, Ronald Arculli, is a member of Hong Kong's senior governing institution, the executive council. That not only gives the government a means of directing strategy; in effect, it also provides a veto against any unwanted takeover from overseas.

In recent years, its leaders have vehemently defended the importance of guarding the independence of the Hong Kong Exchanges and Clearing, as the bourse is officially called. After making a brief—and much regretted—foray into the fraught world of exchange consolidation, it has sneered at deals done between Tokyo and New York, and New York and Europe. It has not sought pan-Asian tie-ups either.

On the surface at least, this independent streak has kept it in fine fettle. It has recently overhauled its systems, its share price is at a record high, giving it a value of above 50 times earnings.

Increasingly, however, Hong Kong has depended on mainland Chinese companies to keep the cash pouring in. Last year 90% of funds raised on the exchange were for Chinese companies. Yet this year the Chinese government has blocked mainland companies from listing in Hong Kong or restricted the amount of shares they could sell. Instead, even the largest companies have been persuaded to list in Shanghai and Shenzhen.

Hong Kong's government, especially Mr Tsang, has been lobbying Beijing to reverse this policy. It would not be a stretch to believe that in return, Beijing would like more sway over the Hong Kong market, and that it may have pushed behind the scenes for a share swap.

Such a deal would be easier to pull off between governments rather than with pesky independent shareholders. So buying them out makes sense.

Of course pesky independent shareholders are supposed to be what exchanges and markets are all about. If they, and their opinions, are stifled in favour of a government that likes to determine who can list and

where, can a true market remain? And if Beijing is, in effect, determining the shape of Hong Kong exchange's business, why should a Hong Kong exchange exist at all?

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Economics focus

Houses built on sand

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From The Economist print edition

America's housing boom was almost modest by global standards—which is worrying

EVERYTHING in America is bigger. Cars, hotel rooms, servings at dinner, the salaries of sports stars and chief executives. So anything that merits the adjective "jumbo" is extravagantly large. Except, that is, for shrimp and home loans. In America a jumbo mortgage is one that exceeds the authorised limit for loans bought and securitised by Fannie Mae and Freddie Mac, the government-sponsored lenders. That cap was increased this year, to $417,000—a sum that, at today's exchange rates and prices, is barely enough to buy a cramped flat in the outer suburbs of London. Could it be that America's housing boom, which has now turned horribly sour, was not even super-sized?

That is what *The Economist*'s table of house-price indicators shows (below). The S&P/Case-Shiller national index, the best gauge of American house prices, peaked last year after rising by 134% in the previous decade. France, Sweden and Denmark have all had booms of similar size. In Britain, Australia, Spain and Ireland, the ten-year increase in house prices has been even larger. If America is staring at a nasty housing crash, what does this say about the fate of frothy markets elsewhere?

***The Economist*'s house-price indicators**

% change

	Latest	Q2 2006	1997-2007
	on a year earlier		
Singapore	21.1	6	na
South Africa	14.5	15.1	380
New Zealand	13.3	10.3	116
Hong Kong	10.6	-1.4	-38
Sweden	9.9	13	138
Britain	9.6	4.8	211
Australia	9.2	7.3	149
France	8.1	12.9	139
China	7.5	5.7	na
Denmark	7.4	25.4	121
Canada	7.3	9.7	65
Spain	5.8	10.8	189
Belgium	5.7	12.4	131
Italy	5.6	6.7	98
Netherlands	5.2	4.9	102
United States	3.2	10	103
Switzerland	1.4	3.7	18
Ireland	-0.7	14.3	251
Japan	-1.6	-3.8	-32
United States (Case-Shiller national index)	-3.2	7.5	120
Germany	-3.4	2.8	na
United States (Case-Shiller ten-city index)	-4.1	9.7	171

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; Standard & Poor's; government offices

Research by David Miles and Vladimir Pillonca of Morgan Stanley concludes that there are likelier candidates than America for a housing bust. In a recent paper covering 13 European countries as well as

America, they assess how much of the rise in property values in the past decade can be put down to bubble-like optimism about future price increases. The authors constructed a model in which housing demand is driven by rising real incomes, population growth and declines in real interest rates. They then estimated the downward effect on prices from increased homebuilding. They argued that what is left—the part of price rises that is unexplained—is without substance and vulnerable to a correction.

In six countries—Belgium, Britain, Denmark, Greece, Spain and Sweden—real house prices have risen much faster than the model predicts. Mr Miles admits that calculation of real interest rates may have distorted the results for Greece. But in the remaining five countries, the average “excess” increase in real house prices is 47%. Some of the paper's results challenge accepted wisdom. Ireland's housing boom, often seen as a spectacular bubble, is almost entirely explained away by rapid real-income growth, rising population and the drop in real interest rates. Nevertheless, Irish house prices are now falling, if modestly.

The other surprise is America. The Morgan Stanley economists reckon the housing boom more or less reflected durable shifts such as rising incomes and population growth. That conclusion, however, hinges on the choice of price index. The authors' gauge of real house-price gains uses the series of the Office of Federal Housing Enterprise Oversight (OFHEO). That index excludes deals above the loan cap of $417,000, where price gains have been greatest, as well as transactions financed by subprime mortgages, where activity was most frenetic. Mr Miles says that using the Case-Shiller index, the assessment is gloomier.

Why America?

Even so, the contrast with events on the other side of the Atlantic is puzzling. Several of Europe's housing markets are more overpriced, but have lost only a little of their fizz in the past year. Price rises in Britain have even accelerated. If America's housing market was less puffed up, why is it alone bursting?

One reason is that America is a big country. Comparing its entire housing market—including slow-growing rural areas—with selected European hotspots makes it look less bubbly. In America's top-ten cities, for example, prices are up 171% in the past ten years, much more than the national average.

But what sets America apart is the time-bomb laid by subprime mortgage lending in the late stages of the housing boom. The way many of these deals were structured—two or three years of low “teaser” rates, which then switch to much higher tariffs—gave homebuyers with tarnished credit records a free option on house prices. If prices are expected to rise enough, borrowers may be willing to pay higher interest charges in order to keep the equity gains. If prices fall short of their hopes, borrowers have an incentive to default.

In short, dangerously loose lending standards fuelled America's housing boom and now the fallout from increasing defaults is exacerbating the bust. Nearly 15% of subprime borrowers are behind with their mortgage payments. The defaults so far have poisoned the mortgage market for prime borrowers too.

The Federal Deposit Insurance Corp, which guarantees bank deposits in America, reckons over 1.5m households will eventually be unable to meet their mortgage payments. Prices are falling and more forced sales will add to the already swollen stocks of unsold homes.

What might this presage for Europe's overpriced markets? Robert Shiller, a seasoned bubble-hunter at Yale University, has stressed the role of news reporting in influencing price expectations. If America's slump deepens, it might trigger a reassessment in Europe's property hotspots, particularly as tighter credit markets start to price out the more speculative investor.

Asset markets are unpredictable. When house prices in London stalled during 2004-05, many pundits thought the spell had been broken. Then the upward trend mysteriously reappeared. As Mr Shiller noted recently: “The London case study should caution any who feel that a substantial decline in home prices in the US is inevitable.” No one knows for sure how markets in Europe might respond to events in America. But one thing is certain: when it comes to asset bubbles, bigger is not better.

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Correction: Standard & Poor's

Sep 13th 2007

Standard & Poor's has downgraded just three of the mortgage tranches it has rated, not 3% as we said last week. Sorry. The article has been corrected online.

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Neurodegenerative disease

Trashing the brain

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Biologists are learning how prions kill brain cells

Paul Box reportdigital.co.uk

SEEMINGLY different diseases can sometimes share a common cause. Tumours of all sorts, for example, are clusters of cells run out of control, dividing incessantly. Over the past decade, another unifying medical principle has emerged. It holds that many diseases of the central nervous system—including Alzheimer's, Huntington's and Parkinson's diseases—also share a mechanism. Instead of non-stop proliferation, the theme in this case is rubbish-disposal gone wrong.

The garbage in question is abnormally folded proteins. These are usually collected by dustmen (molecules called “ubiquitins” that pick up proteinaceous litter) before being taken to the cell's waste-processing centre (a structure known to biologists as the “proteasome”). Healthy cells create plenty of junk that keeps the system busy. The hundreds of steps of folding that create a complex protein can take a cell many minutes to complete. And with so many steps, mistakes often occur, or toxins push a perfectly configured protein out of place. Such wrongly wrought proteins need to be binned before they cause substantial damage.

In the current issue of the *New England Journal of Medicine,* Alfred Goldberg of Harvard Medical School, who helped discover the proteasome 20 years ago, discusses what happens to this waste-disposal system when the brain is infected by a particularly nasty protein called a prion. Prions cause Creutzfeldt-Jakob disease (or “mad cow disease” in cattle) by rearranging the structure of normal proteins in their own image. Recently scientists have started to think that prions might also disrupt the rubbish-disposal system, and that such interference might explain how they destroy nerve cells in the brain. Dr Goldberg proposes that globules of prions plug the waste-processing proteasome. That would cause all cellular garbage disposal to cease. Trash would thus remain in the brain until the accumulating filth killed the nerve cells.

Deadly origami

Sarah Tabrizi of University College London, and her colleagues, have also examined the question of how prions kill nerve cells, transforming the brain into a spongy organ riddled with holes. They used a Petri dish of mouse nerve cells and a fluorescent lamp. The cells they studied had been modified to produce a waste protein that glows green under fluorescent light.

First Dr Tabrizi infected the nerve cells with disease-causing prions. Doing so made them grow more

luminous as their waste proteins accumulated. Then she added an antibody that cleared the cells of prions but left the ubiquitins, the proteasome and the waste proteins in place. As expected, this made the nerve cells dim because they had regained the ability to dispose of their fluorescent rubbish.

A similar experiment using living mice gave corresponding results. When the mice were infected with prions, ubiquitins collected in their brains. Those ubiquitins were pinned to proteins destined for destruction but, after prions had entered the brains, the junk somehow survived.

Although these tests show that prions can force the waste disposal system to malfunction, they did not identify which part of the process went wrong. So, to work out whether the dustmen were on strike or whether the rubbish-crunching centre had been closed down, Dr Tabrizi purified some proteasomes and took a closer look. By carefully measuring the rate at which proteasomes laboured, she found a clear correlation: as the clumps of prions in the sample got bigger, the proteasomes slowed down. Thus it is the rubbish dump that ceases to work rather than the dustmen neglecting their duties.

That infectious prions cause rubbish to accumulate in brain cells may not be the only way in which they cause damage. Alex Greenwood of the Technical University of Munich, in Germany, and his colleagues, have another idea. They believe that infectious prions might wake viruses that lie dormant in the DNA of an uninfected cell.

Dr Greenwood also works with cells taken from mice. These cells contain disabled viruses because murine ancestors, just like human ones, accumulated them in their genomes whenever infections entered their sex cells. Those historical viruses have been largely disabled by evolution over many millions of years, but they remain, they are numerous, and their genomes constitute about 10% of the DNA of most mammals.

Like Dr Tabrizi, Dr Greenwood infected several types of mouse nerve cells with prions. Next, he examined those cells to see whether they started making the previously disabled viruses. He found some in which this was happening. When he added an anti-prion drug to the mix, though, the virus production halted. The research is reported in *Biochemical and Biophysical Research Communications*.

Dr Greenwood's data support the theory that prions stimulate brain cells to make viruses that natural selection long put to bed. He thinks that these viruses might even transport prions between nerve cells, spreading the infection to other parts of the brain. If that idea proves correct, prions would be more than flying pickets that closed municipal dumps. They would be muck-spreaders too.

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Diet and hyperactivity

Food for thought

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Why it is difficult to prove that food additives damage children

JUNK food is unhealthy and many parents avoid feeding it to their kids. But can the combination of colourings and preservatives added to all sorts of food harm children, making it harder for them to concentrate and to learn? That was the question which a team of researchers led by Jim Stevenson of the University of Southampton, in Britain, set out to answer. Their findings suggest that, if there is an effect, it is highly complicated.

In an earlier study the researchers had asked three-year-olds living on the nearby Isle of Wight to swallow drinks containing a cocktail of additives. They found that parents reported a deterioration in the behaviour of hyperactive youngsters fed on a mixture of four food colourings and a preservative. But independent observers noticed no difference.

In an attempt to clarify this contradiction, the researchers repeated the study. This time, they recruited two groups of children typical of those living in the area, aged three and between eight and nine, from nurseries and schools in Southampton. Their study also used two different cocktails of additives as well as a placebo drink that contained no food colourings or preservatives.

The first drink was the same as in the first study, containing a mix of sunset yellow, carmiosine, tartrazine and ponceau 4R with the preservative sodium benzoate. But the manufacturers of sweets and fizzy pop have changed the additives they use in recent years, mostly ditching tartrazine, a violent yellow dye that had been linked to asthma attacks and itching in susceptible people. So the researchers also tested a second concoction chosen to mimic more closely what an average child might reasonably consume every day. It contained sunset yellow, carmiosine, quinoline yellow and allura red, plus sodium benzoate.

The diets of roughly 150 children from each age group were changed so they contained no food colouring or preservatives. Then some of the children were assigned at random to drink one of the two cocktails containing additives daily during three of five weeks, alternating with a placebo. Others were given drinks that did not contain any additives. Neither the children nor those dispensing the drink knew who was drinking what.

To measure the effect of the beverages, the researchers asked parents and teachers to assess the children's behaviour. Observers watched them in the nursery or in the classroom. The older children also sat a computerised test designed to measure attention span. The results of these tests were added together to form an aggregate score for each age group.

The researchers concluded that children quaffing the cocktail containing tartrazine from both age groups were less well behaved than those who had been downing the placebo. The results for the second concoction were less clear. The behaviour of the eight- and nine-year-olds was significantly affected but that of the three-year-olds was not, compared with the children who had not received any additives. Some parents noticed changes when their children received both the additives and the placebo, while others saw behaviour deteriorate with the placebo but not the additives. Moreover the researchers noted that the overall result for the second cocktail concealed large differences in the sensitivity of individual children. The work was published in the September 6th issue of the *Lancet*.

On September 10th the British government agency responsible for food safety—which funded the study—revised its guidelines in light of the study's conclusions. It recommends that parents of children who show signs of hyperactivity should consider cutting some artificial colours from their diets. The agency says it will share its findings with its European counterpart which, at the behest of the European Commission, is reviewing the safety of all the food colourings that are used in Europe.

Dr Stevenson meanwhile cautions that parents should not think that simply removing food additives from a child's diet would prevent their offspring from becoming hyperactive. Children with the severest form,

called “attention deficit hyperactivity disorder”, exhibit such disruptive behaviour that it impairs their learning and function at home and at school. It may affect some 5% of the population. Yet less than half of these children see any improvement if they modify their diets. Medics suspect that the condition is at least partly genetic.

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Space

Eyes on the prize

Sep 13th 2007 | NEW YORK
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The lunar race hots up

FIFTY years ago next month, the Soviet Union stunned the world when it launched *Sputnik*. America responded with a lunar effort that culminated in 1969 with the successful manned *Apollo* landing. Three years ago, George Bush tried to recapture the magic by declaring that America will return to the moon. Now private efforts are adding impetus.

China and the European Union have plans for unmanned lunar missions. Japan is expected to launch a robotic lunar orbiter shortly. But Mr Bush says he wants a human settlement on the moon as a staging post for manned forays to Mars.

Peter Diamandis, the head of the X Prize Foundation, a charity that encourages the building of spaceships, thinks this top-down approach is as outdated as the cold war itself. Politicised government agencies and bureaucratic aerospace contractors are too slow, he insists, and manning lunar missions adds needless risk and complexity.

So Mr Diamandis's group plans to bypass governments altogether. As *The Economist* went to press on September 13th, the X Prize Foundation and Google were due to announce a new international competition to put an unmanned rover on the moon within five years. The internet giant is putting up $30m to sponsor the prize—with lunar videos to be featured on the firm's YouTube site.

The first non-governmental team to land a vehicle safely, drive it for 500 metres and beam back high-quality videos will win $20m, so long as the task is completed by 2012. (The jackpot falls to $15m if the rover does not reach the moon until 2013 or 2014.) There is a $5m prize for the second-place team, as well as bonuses for detecting water, travelling farther and surviving a lunar night.

Will this really spark a private-sector space race? One is already under way. Several dozen firms are busy developing cheap technologies for satellite launches, “rocket racing” games and space hotels. The same foundation helped spark this frenzy with its earlier $10m Ansari X Prize, which started a race to develop reusable vehicles for suborbital travel. Virgin Galactic, an arm of Sir Richard Branson's empire, is commercialising the winning technology from that prize and will soon be flying its first batch of paying customers.

Whether the new prize has the same catalytic effect remains to be seen. Larry Page, Google's co-founder, is convinced, and Mr Diamandis remains gung-ho. Those on the business end of space vehicles are a bit more cautious. Elon Musk, whose Space Exploration Technologies is developing rocket-launch technology, warns that it will not be easy. To oil the wheels, he is offering contestants cut-price launches. Watch that space.

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Female genital mutilation

A cut less cruel

Sep 13th 2007 | OUAGADOUGOU
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An attempt to restore sexual sensation to women whose genitals have been cut

A QUARTER of a century after the start of campaigns to stop communities from maiming their young women, the practice still goes on. Female genital mutilation, to give it its proper name, ranges from a straightforward nick to the complete excision of the clitoris and labia with the remaining genitals sewn up, leaving only a small opening. It is done for cultural reasons in many African countries but also in Asia and the Middle East. The World Health Organisation estimates that some 3m girls are subjected to the procedure each year and that, in total, between 100m and 140m women have undergone it. But now surgeons are working to repair some of the damage.

Surgery to reopen the vagina and mitigate the medical complications of genital cutting has long been available. But in Burkina Faso, where as many as 75% of women are thought to have had their clitorises cut, a relatively new procedure is being offered. Clitoris-reconstruction surgery aims to restore sexual sensation to women who have been mutilated. A year after it was introduced, more than 100 women have elected to have it performed, according to Michel Akotionga of the Yalgado Ouedraogo University Hospital in Ouagadougou. Unlike surgery to reopen the vagina, which is free in Burkina Faso, clitoris reconstruction costs about $150 in a public hospital and up to $400 in a private clinic.

The technique is possible because most of the clitoris resides inside the female body. In cases where the entire external part has been severed, some 2cm is removed but a further 8-10cm remains embedded internally. Surgeons pull it out and stitch it to the skin. Nerve endings in the new protrusion help to create the secretion and engorgement in the genitals that prepare a woman for sex. Unfortunately the technique used by the Burkinabe doctors does not restore sexual sensation completely, because the pressure-sensitive tip of the clitoris is lost.

Pierre Foldes, who started pioneering the reconstruction method some 25 years ago, has now trained 15 surgeons to use the technique in France. Although he supports efforts to restore sexual sensation, he worries that improperly trained surgeons may cause more damage in attempting to repair mutilated women.

Other health workers fear that families unsure of whether to subject their young women to genital mutilation might go ahead on the grounds that a wrong decision can always be corrected later. While a partial cure is better than nothing, prevention would be best of all.

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Exoplanets

Survivor

Sep 13th 2007
From The Economist print edition

A planet avoids being engulfed

THE Book of Revelation has the world ending in a fiery hell. Astronomers have long come to a similar conclusion: that the Earth will be obliterated by a giant fireball as the sun burns up and expands so that its surface touches the planet. Recently, though, they have spotted somewhere that has managed to avoid such a fate.

This planet is orbiting a star in the Pegasus constellation some 50 light years away. The star used to be like the sun, a “main sequence” star that burns hydrogen by nuclear fusion, producing helium. A star can persist like this for 10 billion years. But after that, the hydrogen begins to run out. Instead of fusion taking place in the stellar core, it fizzles towards the surface. The thinner outer layers of the star cannot contain the nuclear reactions so tightly, and the star balloons, obliterating nearby planets.

Roberto Silvotti of the National Institute for Astrophysics in Naples and his colleagues spotted the planet, a gaseous giant like Jupiter, circling a star called V 391 Pegasi. The star is in its twilight years, having become a red giant. However it is unusual in that it lost much of the hydrogen from its surface as it ballooned. Only about 2% of red giants follow this fate, to become stars known as “B-type subdwarfs”. This one also radiates with a regular rhythm.

By looking for changes in this pulsing of the star, Dr Silvotti deduced that a planet was orbiting it. Moreover, he was able to measure the tiny delays in the arrival of its pulses that were caused by the planet whipping around it, tugging it to and fro. From these minuscule shifts, the team estimated that the planet is about three times the mass of Jupiter, and orbits its star at a distance slightly greater than that between Mars and the sun.

The researchers reckon that the planet was once at a distance roughly equal to that of the Earth from the sun, and that when it expanded, the red giant star would have encompassed some 70% of that distance. The planet then spiralled out to take up its present orbit. They report their work in the September 13th issue of *Nature*.

The discovery suggests that the Earth may survive the explosion of the sun, even if life on Earth would not. If so, the end might come not in a blaze of glory but in the cold darkness of a universe that expands for ever.

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The cold war

A history of lost opportunities

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From The Economist print edition

It might all have been different if the leaders of the United States and the Soviet Union had not, so often, found themselves swept along by events

For the Soul of Mankind: The United States, the Soviet Union and the Cold War
By Melvyn P. Leffler

Hill and Wang; 608 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

Corbis

WITH more than a year to go before the election, America's presidential campaign is entering a decisive phase. Numerous states have moved up the dates of the crucial first round—the party primaries and caucuses—to the very start of 2008. To the campaign teams, it is unnervingly clear that a painful culling of candidates will take place soon. Would-be presidents are therefore searching for ways to raise their profile, partly by publicising their visions of how America will interact with the world in the post-Bush era.

Into this mix arrives a highly relevant and much-needed historical study by one of the world's senior scholars of American foreign policy, Melvyn Leffler, a professor at the University of Virginia. “For the Soul of Mankind” assesses both what went wrong and what went right in America's diplomatic, military and political interactions with the Soviet Union during the thermonuclear stand-off of the cold war. The title,

which Mr Leffler has taken from a remark by George Bush senior, shows how significant the author considers this subject to be. This is one of the best books on the period to have been written.

Mr Leffler focuses loosely on several moments of tension between the American and Soviet leaders. They include the Truman-Stalin contest over occupied Germany, culminating in the Berlin airlift of 1948-49, the Cuban missile crisis in 1962 and the tussle between Ronald Reagan and Mikhail Gorbachev over America's "star wars" missile-shield programme in 1986. Mr Leffler sees his book as "a history of lost opportunities" when the cold war could plausibly have taken another course.

He tells a tale of nascent initiatives confounded by events. The combination of the two produced unforeseen results. He argues that neither America nor the Soviet Union intended to start a cold war over Germany, but "conditions in the international system created risks that Truman and Stalin could not accept and opportunities they could not resist." Caught in a web of fear, ideology and temptation, the two leaders ended by entangling their countries in long-term conflict.

The book succeeds in being even-handed: both sides come under careful scrutiny. To describe the American home front during and just after the second world war, Mr Leffler employs a famous statement by John Kenneth Galbraith: "Never in the history of human conflict has there been so much talk of sacrifice and so little sacrifice." But the author has no patience with nostalgia for Stalin either: he is clear about the brutality of the man.

Mr Leffler believes in the importance of individuals and their decisions, even if only to understand how both become derailed. "The cold war was not predetermined. Leaders made choices," he writes. And, at the end, the choices that mattered were Russian ones. He argues that though America shaped the nature of the contest, Gorbachev was the key figure in its ending. In contrast to such scholars as John Lewis Gaddis, Mr Leffler finds that "Reagan was critically important, but Gorbachev was the indispensable agent of change."

Any broad-brush survey such as this one will have its gaps and "For the Soul of Mankind" is no exception. Mr Leffler believes passionately that American policymaking towards the Soviet Union defined the second half of the 20th century. He is right, but he could have paid more attention to the leaders of other countries who helped to limit or expand the parameters of the possible. Nor is his choice of title entirely convincing. American and Soviet leaders clearly tried to shape strategy, but did they really struggle to save souls (as opposed to lives)? It is one thing for a politician to say so, another for a historian to adopt the same line, and requires more analysis than is given here.

But the shortcomings of Mr Leffler's book are few and his conclusion is powerful. He laments that all too often "ideology and historical experience" intensified American leaders' sense of threat "and tempted them to overreach when danger loomed." At their best, American presidents maintained a delicate balance between power and restraint. They realised that they needed to achieve their goals not through war but through close co-ordination with allies. The book argues that, had they not lost this balance during periods of tension, they might have seen the opportunities hidden beneath the dangers.

Although Mr Leffler (wisely) leaves parallels to the present day implicit, he clearly has an important lesson to offer: a crisis is a terrible thing to waste. It makes unthinkable changes suddenly possible. International relations would look very different now if America, in the spirit of the better days of cold-war transatlantic co-operation, had seized the fleeting "we-are-all-Americans" moment after September 11th 2001. It could have accepted European offers of increased military collaboration rather than pursuing unilateral action. Without saying so explicitly, Mr Leffler leaves the unmistakable impression that the next person sitting in the Oval Office will find the road back to collaborative policymaking very long indeed. Campaign staffers writing foreign-policy statements for candidates, please take note.

For the Soul of Mankind: The United States, the Soviet Union and the Cold War.
By Melvyn P. Leffler.
Hill and Wang; 608 pages; $35

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An assessment of Tony Blair

The politics of trust

Sep 13th 2007
From The Economist print edition

“GOD, why is betrayal the only truth that sticks?” asks the main protagonist in Arthur Miller's “After the Fall”, a play about failed relationships and political cowardice. Martin Bell follows a similar line in “The Truth that Sticks”, the first book to assess Tony Blair's impact on Britain since the former prime minister left office in June. His thesis—that Mr Blair betrayed the confidence of the people by failing to clean up politics at home, and by misjudging and lying about the situation in Iraq—is familiar. So why bother to read him?

The Truth that Sticks
By Martin Bell

Icon Books; 294 pages; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Mainly, because of who he is: Mr Bell knows whereof he speaks, at home and abroad. A correspondent who reported from war zones for 30 years, he quit the BBC in 1997, defeated a Conservative candidate and entered Parliament as that rarest of birds, an independent. His theme in those days was also Mr Blair's: that an honest and open new government would defeat the sleaze that had engulfed its predecessor and reform the system to make it more genuinely democratic.

Mr Bell sat on the select committee for standards and privileges for most of his four years in Parliament and catalogues the stream of only occasionally punished misdeeds that passed before that body. He lambasts Mr Blair for failing to take seriously the challenge of public morality and for concentrating power within the executive, thus leaving the House of Commons “a sort of ill-tempered Hogwarts [Harry Potter's alma mater]”. Tony Blair's real political legacy, he maintains, was “to threaten with ruin the party he led but never really cared for”.

After the 2001 general election Mr Bell returned to his writing and travelling and occasional broadcasts. And his book, after a fast 90 pages on domestic matters, surges off into the territory he likes best: foreign parts, where men are men and wear flak jackets of necessity, not as political accessories. His account of the “dodgy dossier” of intelligence information that helped persuade Parliament to vote for the invasion of Iraq, the misrepresentation of the nature of Britain's engagement in Afghanistan, the sidelining of the Foreign Office and the politicians' lack of care for the soldiers who were asked to do ever more with relatively little, makes painful reading even though it does not break new ground.

Mr Bell's account of all this is passionate and principled, and it is right on many counts. But not on all. That the Blair government failed lamentably to fulfil its pledges is not in doubt; but it did erect many of the hurdles—such as more transparent reporting of political contributions—that it then stumbled at. Governmental reform was botched but some, at least, took place. On Iraq, Mr Bell does suggest that Mr Blair misled himself as much as he misled others. This points up an important truth.

Mr Blair had (and perhaps still has, in his new role as peace envoy in the Middle East) a sense of destiny but not of history. Only an historical illiterate would have assumed that the divided Iraqis were bound to thank their invading liberators and coalesce in democratic government. He was convinced that he was right; and the past was no guide for him.

Mr Bell's book reads at times like a collection of essays, or extended columns, and it may well be just that. The balance is not perfect: the 12 pages devoted to cluster bombs, for example, seem a bit excessive when a topic as fundamental to Britain as the reform of public services is untouched. The reforms that Mr Bell himself proposes are modest.

But his criticisms bite, and he will soon be followed by other sharp-toothed Blair biographers. His emphasis on the importance of the bond of trust between government and voter could not be more timely, as Gordon Brown, the new prime minister, and David Cameron, the newish leader of the Conservative opposition, struggle to get the post-Blair edge. “This is the political pendulum that matters,” writes Mr Bell, “swinging not between right and left but between the politicians who can be

trusted and those who cannot.”

The Truth that Sticks
By Martin Bell.
Icon Books; 294 pages; £16.99

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Statistics

Don't panic

Sep 13th 2007
From The Economist print edition

NUMBERS get a bad press. Almost alone of the academic disciplines, mathematics is one where expressions of ignorance are more of a boast than a shameful admission (imagine admitting at a dinner party that you can't read).

Yet numbers are more important than ever. They are the language of most of science and much of government, two forces that do much to shape people's lives. They are the nervous system of any modern country, marshalled in support of arguments over everything from defence to which diseases should be treated.

Happily for the number-shy, help is at hand. A book about numbers and how to interpret them doesn't sound like interesting bedtime reading. Yet in the hands of Michael Blastland and Andrew Dilnot, respectively producer and presenter of "More or Less", a BBC radio programme on the subject, that is what it becomes.

The chapters proceed from simple concepts to more complicated ones, starting with the simplest of all: working out how big a number is. That is harder than you might think. The British government's promise to spend £300m ($600m) over five years on child-care looks impressive at first glance. Only after working through the calculations does one realise that it amounts to only £1.15 a week for every family.

The authors avoid a hectoring tone. Their prose is light-hearted and never condescending. Amusing (or occasionally frightening) examples make theoretical arguments instantly accessible. The authors point out that most people have a higher-than-average number of feet (it takes only a single man with one foot to bring the average below two). Incomes are the other way around: thanks to a few billionaires, most people earn less than the average.

Later on, trickier and more emotive subjects are tackled. Much of the second half is taken up with the devilishly tricky business of trying to extract causation from correlation. One such issue is the so-called "cancer clusters". A mobile-phone mast is erected in a village. Soon after, cancer rates rise to several times the national average. But masts are common, and some villages are bound to develop high cancer rates through nothing more sinister than sheer bad luck. Proving correlation is easy, but proving causation—despite how obvious the links may seem—is not. The authors make the sobering point that mortality rates for doctors vary so much that, even if he had been constantly monitored, Harold Shipman (a British doctor who murdered at least 200 patients) would have racked up a body-count of several dozen before coming to official attention.

The central problem, as the authors admit, is that numbers can often be deeply counter-intuitive. Individuals find it difficult to cope with the vast quantities of cash consumed by a modern nation state, and everyday rules of thumb can sometimes lead to utterly wrong conclusions. That is what makes this book so valuable: it provides a reliable guide to a treacherous subject, giving its readers the mental ammunition to make sense of official claims. That it manages to make them laugh at the same time is a rare and welcome feat.

The Tiger that Isn't: Seeing Through a World of Numbers
Michael Blastland & Andrew Dilnot.
Profile Books; 185 pages; £12.99

The Tiger that Isn't: Seeing Through a World of Numbers
By Michael Blastland and Andrew Dilnot

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Buy it at
Amazon.co.uk

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New novel

Sweet and smart

Sep 13th 2007
From The Economist print edition

EVEN terrorists had hearts of gold in Ann Patchett's last novel “Bel Canto”. In “Run” the author likewise spurns villains, doling out sympathy to all concerned. What she sacrifices in edge, she gains in warmth. For novelists, compassion may be the greater part of valour.

Doyle, a former mayor of Boston and himself white, is father to one biological son named Sullivan and two younger adoptive black siblings, Tip and Teddy. Everyone is likeable. Doyle's liberalism appears heartfelt, even if a snake of hypocrisy does sometimes twine with his pursuit of virtue. Now in their early 20s, Tip and Teddy are well-behaved and affectionate, although little interested in the politics their father foists upon them (Teddy is obsessed with Catholicism, Tip with fish). Both boys still pine for their loving adoptive mother, recently deceased. Sullivan may fill the formal role of family black sheep, yet he too proves tender.

Run
By Ann Patchett

HarperCollins; 304 pages; $25.95.
Bloomsbury; £14.99

Buy it at
Amazon.com
Amazon.co.uk

The hook: as Doyle and Tip argue outside the Jesse Jackson lecture to which their father has dragged the younger boys, a black woman careers out of nowhere and pushes Tip from the path of an oncoming car. Tennessee, the stranger who takes the brunt of the impact herself, turns out to be Tip's and Teddy's birth mother, who along with her daughter Kenya has been covertly keeping tabs on her sons while living a stone's throw from their house. When Doyle reluctantly takes charge of 11-year-old Kenya while her mother languishes in hospital, loyalties grow tangled.

Themes of class and race in “Run” are present, of course, but gratifyingly quiet, gurgling under the novel like an aquifer and never quite surfacing. The novel is well plotted and Ms Patchett's universally sympathetic portraiture produces engaging characters. The writing is seamlessly smooth but never ostentatious, pushing story to the fore. Yet single passages do rise a notch in flourish: “Tip was smarter and Teddy was sweeter. They had heard it since a time before memory. Sweet and Smart or Smart and Sweet. Either way it should have been a name of a magazine for teenaged girls or a brand of hard candy or a sauce for crispy duck.” Nicely put.

Run.
By Ann Patchett.
HarperCollins; 304 pages; $25.95.
Bloomsbury; £14.99

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Automated decision-making

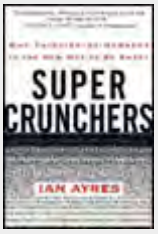
The death of expertise

Sep 13th 2007
From The Economist print edition

EVERY time a world-class chess player loses to a computer, humans die a little. In this book Ian Ayres, a professor of law and management at Yale University, explains how in many less high-profile endeavours, human intuition and flair are more easily beaten. The sheer quantity of data and the computer power now available make it possible for automated processes to surpass human experts in fields as diverse as rating wines, writing film dialogue and choosing titles for books.

The author originally intended to call his book “The end of intuition”. He changed his mind after a Google AdWords campaign which randomly chose which of two advertisements for the book to display: “Super Crunchers” garnered 63% more clicks than his original choice. He tells of credit card companies that are using similar randomised trials to see which combination of offers and advertising make for the most successful mailshots.

Super Crunchers
By Ian Ayres



Bantam Dell; 260 pages; $25; John Murray; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Even the occasional government is accepting that properly analysed data trump ideological conviction. Mr Ayres sings the praises of Mexico's Progresa/Oportunidades programme, which gave assistance to poor people only if their children attended health clinics and schools. It was tried out on 506 randomly selected villages. The results were so convincing that the programme was expanded 100-fold despite a change of government.

Mr Ayres predicts that automated decision-making will soon see other professional jobs going the same way as that of the bank-loan officer, once well-paid and responsible and now a mere call-centre operative, paid peanuts to parrot the words a computer prompts. Doctors will have to face up to the fact that computers can diagnose illnesses better than they can, and teachers will find that although their presence is needed to engage their pupils, their professional judgment often is not. When teaching small children to read, for example, tightly scripted lessons, their exact content and timing honed by randomised trials, do best.

This book does not touch on what Nicholas Nassim Taleb calls “Black Swans”: rare events that are unpredictable with or without crunching numbers. But it presents a convincing and disturbing vision of a future in which everyday decision-making is increasingly automated, and the role of human judgment restricted to providing input to formulae.

Super Crunchers
By Ian Ayres
Bantam Dell; 260 pages; $25; John Murray; £16.99

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Turkish music

In memory of the Ottoman court

Sep 13th 2007
From The Economist print edition

A Swiss musician sets out to restore the purity of Turkey's musical lore

“NEITHER the sweets of Damascus, nor the face of the Arab.” This Turkish adage sums up the disdain modern Turks have long expressed for their Arab neighbours, a disdain that became fashionable with the founding of the republic by Ataturk, who in his zeal to make Turkey Western set about erasing all traces of its Ottoman past, including its links to the Arab world. The court music of the sultans was not spared and soon was buried in a layer of Western instruments like the violin and the piano. The result, according to Julien Jalal Eddine Weiss, an expert on classical Arab and Sufi music, was like “using African bongos in a Mozart sonata”.

Mr Weiss, a Franco-Swiss convert to Islam, has been based in Aleppo for the past two decades, refining his mastery of the *qanun* (the Arab zither) and playing with the masters of Arab classical music. He moved to Istanbul last year with the mission of returning Turkish music to its roots, which he argues are undeniably Arab.

It is a daunting task in a country where in the late 1940s Egyptian film music was banned because of its influence on Turkish popular songs. These days the quality of Turkish music is measured by its success at the Eurovision song contest. Turkey's winning entry in 2004 was an up-tempo pop tune with English lyrics.

But Mr Weiss's arrival in Istanbul coincided with the burgeoning of Turkish curiosity about their Ottoman and Sufi roots. Ottoman styles and cuisine are increasingly *de rigueur*. In Beyoglu, the hub of Istanbul's alternative art scene, street musicians are trading in their guitars for *ouds* (an oriental string instrument) and the *ney* (a flute traditionally played by dervishes).

From this fertile mix, Mr Weiss has added three Turkish musicians to his mainly Arab al-Kindi ensemble. The fruit of this collaboration is an ambitious double album “Parfums Ottomans” that purports to render Ottoman court music in its purest form. The virtuosity of Mr Weiss and his fellow musicians is beyond doubt. “Parfums Ottomans” is an intoxicating journey back in time: it is easy to visualise the sultans reclining on their divans smoking water pipes as they listen (much as Mr Weiss, clad in oriental pyjamas, does on the pink velour floor cushions of his Istanbul home). The complexity of the music, plaintive and repetitive, shines through, thanks to the uncluttered performance of his ensemble.

Mr Weiss sees no contradiction in the fact that it is he rather than a Turk who is restoring the purity of Turkey's musical lore. Apart from the oral tradition, he relies on two 17th-century manuscripts as his main sources for reconstructing the music of the Ottoman court. One was written by Wojciech Bobowski, a Polish Jew who converted to Islam. The other was transcribed by a Moldavian Christian, Prince Dimitrie Cantemir, who studied music in Istanbul.

But Mr Weiss, who has performed to critical acclaim at the Carnegie Hall in New York and the Théâtre de la Ville in Paris, has yet to find a Turkish sponsor. “[The Turks] have no interest in me,” he shrugs. Might they find this interloper presumptuous? He responds with true Sufi detachment: “It doesn't really matter.”

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London's Learned Societies

Uproar at the aviary

Sep 13th 2007
From The Economist print edition

But now all is at peace, with much billing and cooing

IT IS quite a feat to be invisible while occupying substantial buildings in central London flanking the Royal Academy of Arts. But that's just what the Linnean Society, the Royal Society of Chemistry, the Geological Society of London, the Society of Antiquaries of London and the Royal Astronomical Society managed to do for nearly a century. Then, in 2004, Her Majesty's Government not only noticed but also questioned their right to remain at Burlington House, as the complex is called. To the Learned Societies this may have seemed a bitter irony. In 1857, the government of a previous queen had built Burlington House expressly to house them all. Reverence for such institutions, along with the value of real estate, was not what it had been in Victoria's day. But their terms of occupancy remained unchanged.

When they moved into Burlington House, only the Royal Academy, run by supposedly impractical artists, asked for a lease. It was given 999 years at a peppercorn rent. The Societies and their allegedly hard-headed scientist members, were leaseless and rent-free. As decades passed, keeping a low profile must have seemed a sensible idea. Indeed, by 1920, some fellows of the Society of Antiquaries of London (SAL), thought it essential. When a 1919 Act of Parliament made it illegal to bar women from such societies merely because of their gender, a committee of SAL fellows pressed for immediate action: women must be invited to become fellows at once. This was not in order to right previous wrongs. It was to avoid criticism and with it the risk that people might notice that no rent was being paid. The danger averted, heads stayed below the parapet.

But danger reappeared in 2004. With the reputed aim of clarifying SAL's presence at Burlington House, the government brought a suit against it. Rumour swept through intellectual London that, in fact, the government wanted to turf the Societies out—or to get a full market rent, which would have amounted to much the same thing. Alarmed feathers from five aviaries of rare birds went flying.

Now, three years later, feathers are smooth. Indeed, cooing can be heard occasionally from Burlington House. Compromises reached with the government have given the Learned Societies security of tenure at affordable rents. In return, the Societies have begun introducing themselves to one another and to the public.

They have created a “cultural campus” in the courtyard to share scholarship and conviviality—and reflect their new appreciation that there is strength in numbers. Earlier this year, the Linnean Society announced it was producing a digital archive of its priceless collections of specimens, manuscripts and letters of the world famous Swedish naturalist, Carl Linnaeus, on this the 300th anniversary of his birth.

The SAL, also 300 this year, is celebrating with a nine-month series of lectures. On September 26th, David Starkey, one of the most high-profile of its 2,300 fellows, will talk about “The Antiquarian Endeavour” at St James's Church, Piccadilly. On November 8th at Harvard, home to many of SAL's 100 American-based fellows, Felipe Fernández-Armesto tackles “Don Francisco's nose-piece: forming new empires in Renaissance America”. The biggest birthday event is an exhibition of 150 of SAL's treasures at the Royal Academy from September 15th to December 2nd. Among these treasures is an oil on oak portrait of Queen Mary I painted by Hans Eworth in 1554 and a glowing 12th-century enamel casket designed to hold the remains of Thomas Becket. How good that invisibility is a thing of the past.

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Luciano Pavarotti

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From The Economist print edition

Luciano Pavarotti, the world's favourite tenor, died on September 6th, aged 71

AP

HE REMEMBERED the moment it began, at four years old: jumping on the kitchen table, setting the lamp swinging, singing “La donna è mobile” to an audience of adoring women. His father sang, beautifully, as a tenor in the church in Modena; the soaring voices of Gigli and Caruso filled the house from the crackling gramophone; at the cinema Mario Lanza sang and young Luciano Pavarotti copied him, warbling and gesturing into the mirror. To sing was to be loved.

Football was still his chief obsession. Yet as his musical career unfolded, it crossed paths with the Beautiful Game. He performed in stadiums, in front of thousands. The final of the 1990 World Cup in Rome was marked by a concert with Plácido Domingo and José Carreras, “The Three Tenors”, who then sang together for 13 years. Pavarotti's version of “Nessun dorma” from Puccini's “Turandot”, the anthem of that World Cup, came to epitomise all the drama, glory and pain of football, with his three climactic “vinceros” at the end of the aria like a perfect free kick, rising, arching, landing sweetly on the very note, safe in the corner of the net.

Pavarotti made it seem so easy. “Natural” and “effortless” were the words most often applied to that smooth, honeyed, gorgeous voice, which made skin break out in goose-bumps and raised the hairs on the back of the neck. *Lasciare andare*, pouring it forth. No matter that the singer was huge and almost immobile, his beard blackened with burnt cork and his face running with sweat mopped away with an enormous white handkerchief; the smile was ecstatic, and the voice was from heaven. His biggest break had come, in 1972, when he hit nine high Cs in Donizetti's “La Fille du Régiment”; he was dressed then like a fat toy soldier, patently unable to act, but the crowd adored him. He took 17 curtain calls and, by his death, held the world record for them.

The easiness and naturalness were deceptive. He was terrified of the high notes, full of the usual performer's superstitions: a bent nail kept in his pocket, and a quick cry of “Malocchio!” if anyone mentioned bad luck. Though his voice showed no strain, he could be seen rising on the balls of his feet in recital, using every sinew and nerve to produce the sound. Wherever he went, he made sure to surround himself with home comforts: espresso machines, prosciutto-slicers, bottles of Lambrusco, his blotter and pens laid out exactly as they would be on his desk in Modena, and a secretary—nubile, pretty, obliging—who would hold up cue cards for him in the wings and who, when needed, would warm his extra-marital bed.

Critics and other singers often called him lazy. He seemed as undisciplined in singing as he was about food, abandoning diet after diet in favour of porterhouse steaks or caviar scooped up with a tablespoon. Certainly he was unintellectual, without conservatory training and barely able to read music. Learning from a score, he once said, was “like making love by mail”. Words—even those of “O sole mio”, every

tenor's meal-ticket—were hard to drum in; in opera or recital he almost never ventured out of his crisp, supple Italian. Narrow as his repertoire was, he was choosy in it: “Tosca”, “Rigoletto”, “Un Ballo in Maschera”. His tendency to cancel got him banned from several houses and soured his farewell at the New York Met.

Macaroni for the masses

Yet Pavarotti knew what he was doing. He took things easy, hid throat lozenges in his handkerchief, and looked after his instrument. His voice was “gifted from God”; he sang purely by instinct, aware of “how it should go”, and trusting that a good conductor could follow after him. The sheer beauty of his sound, without acting and without musicianship, could bring the audience to its feet, and he would earn the hard-negotiated money that made him the highest-paid singer in opera.

He was also a natural populist in a field that was sniffy and exclusive, bringing to the Met and Covent Garden a sense of opera as Italian peasant fare, “macaroni” for the masses. Larry King once asked him about singing for the elite. “Why should be elite, music?” came the reply. Pavarotti went on “The Tonight Show” and “Saturday Night Live”; in his charity concerts he performed with Elton John and the Spice Girls. When critics sniffed about “popera”, he fought back stoutly: “If you call pop singer, you can sell the ticket.” The numbers backed him up: live audiences in the hundreds of thousands, TV audiences in the millions, more than 50m albums sold, five Grammys. “The word ‘commercial’ is exactly what we want,” said the maestro, who also starred in TV ads for American Express. “If you want to use...something more derogatory, we don't care.”

To the frustration of his rivals, though they were gentlemanly about it, Pavarotti became the world's favourite tenor. He was the first opera star to be imitated, drunkenly, by legions of joyful or heartbroken football fans. Still crazy for football himself, he never minded. For all his frustrations, sulks and cancellations, a life spent bringing music to mankind was the greatest joy imaginable: singing, and then the crowd's adoration for his singing, as he jumped from the kitchen table and the cheese, the wine, the pasta and the sausages were lavishly spread before him.

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Overview

Sep 13th 2007
From The Economist print edition

American employers, excluding farms, cut 4,000 workers from their payrolls in August, the first decline in four years. Payrolls for June and July were revised down by a total of 81,000. The unemployment rate held steady at 4.6% in the face of job cuts, because of a sharp fall in the number of willing workers.

A rising share of **American mortgage holders** are behind with their payments. The delinquency rate on home loans rose from 4.8% to 5.1% in the second quarter. The rate for subprime loans rose from 13.8% to 14.8%.

China's consumer prices rose by 6.5% in the year to August, the highest rate in more than a decade. The main source of inflation pressure was food prices, which were 18.2% higher than a year earlier.

GDP in **Japan** fell by 0.3% in the second quarter, revised from an increase of 0.1%.

Sweden's central bank announced that it would raise its benchmark interest rate by 0.25 percentage points to 3.75% from September 12th. Consumer prices in Sweden rose by 1.8% in the year to August, down from 1.9% in July.

Industrial production in the **euro area** rose by 0.6% in July leaving it 3.7% higher than a year earlier. There were strong increases in output in France and Ireland.

The unemployment rate in **Britain** was 5.4% in the three months to July, down from 5.5% in the three months to April.

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Output, prices and jobs

Sep 13th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.9 Q2	+4.0	+2.0	+2.6	+1.4 Jul	+2.4 Jul	+4.1	+2.7	4.6 Aug
Japan	+1.6 Q2	−1.2	+2.4	+2.2	+3.2 Jul	nil Jul	+0.3	nil	3.6 Jul
China	+11.9 Q2	na	+10.5	+9.6	+17.5 Aug	+6.5 Aug	+1.3	+3.0	9.5 2006
Britain	+3.0 Q2	+3.3	+2.9	+2.4	+0.9 Jul	+1.9 Jul**	+2.4	+2.4	5.4 Jul††
Canada	+2.5 Q2	+3.6	+2.5	+2.7	+0.3 Jun	+2.2 Jul	+2.3	+2.4	6.0 Aug
Euro area	+2.5 Q2	+1.2	+2.7	+2.3	+3.7 Jul	+1.8 Aug	+2.3	+2.0	6.9 Jul
Austria	+3.8 Q2	+4.0	+2.9	+2.6	+6.0 Jun	+2.1 Jul	+1.7	+1.8	4.3 Aug
Belgium	+2.9 Q2	+2.4	+2.6	+2.3	+3.3 Jul	+1.1 Aug	+1.6	+1.8	11.9 Aug‡‡
France	+1.3 Q2	+1.3	+2.0	+2.2	+2.6 Jul	+1.2 Aug	+1.9	+1.5	8.0 Jul
Germany	+2.5 Q2	+1.0	+2.8	+2.3	+4.4 Jul	+1.9 Aug	+1.7	+2.0	9.0 Aug
Greece	+4.2 Q2	na	+3.7	+3.2	+3.5 Jul	+2.5 Aug	+3.5	+2.6	7.7 May
Italy	+1.8 Q2	+0.5	+2.0	+1.7	−0.1 Jun	+1.6 Aug	+2.2	+1.9	6.2 Q1
Netherlands	+2.4 Q2	+0.6	+2.7	+2.6	+4.1 Jul	+1.1 Aug	+1.7	+1.8	4.7 Jul††
Spain	+4.0 Q2	+3.2	+3.7	+2.8	+2.0 Jun	+2.2 Aug	+3.7	+2.7	8.0 Jul
Czech Republic	+6.0 Q2	+5.7	+5.2	+4.0	+6.9 Jun	+2.4 Aug	+3.1	+2.6	6.4 Aug
Denmark	+0.6 Q2	−1.6	+2.1	+2.0	nil Jul	+1.1 Aug	+2.0	+1.8	3.3 Jul
Hungary	+1.4 Q2	+0.8	+2.7	+3.0	+9.4 Jul	+8.3 Aug	+3.5	+7.5	7.0 Jun††
Norway	+3.9 Q2	+3.5	+2.7	+2.5	−4.0 Jun	+0.4 Aug	+1.9	+0.8	2.5 Jun††
Poland	+6.7 Q2	na	+6.3	+5.1	+10.4 Jul	+2.3 Jul	+1.1	+2.3	12.0 Aug‡‡
Russia	+7.8 Q2	na	+6.7	+6.2	+7.8 Jul	+8.7 Aug	+9.7	+7.8	5.9 Jul‡‡
Sweden	+3.6 Q2	+3.9	+3.5	+3.2	+5.2 Jul	+1.8 Aug	+1.6	+1.8	4.8 Aug‡‡
Switzerland	+2.8 Q2	+3.0	+2.4	+2.1	+7.3 Q1	+0.4 Aug	+1.5	+0.7	2.6 Aug‡‡
Turkey	+3.9 Q2	na	+6.0	+5.2	+3.9 Jul	+7.4 Aug	+10.3	+9.0	8.9 Q2‡‡
Australia	+4.3 Q2	+3.8	+3.8	+3.4	+5.5 Q1	+2.1 Q2	+4.0	+2.4	4.3 Aug
Hong Kong	+6.9 Q2	+8.2	+6.2	+5.2	−1.5 Q1	+1.5 Jul	+2.3	+1.9	4.1 Jul††
India	+9.3 Q2	na	+8.4	+7.9	+7.1 Jul	+6.5 Jul	+6.7	+5.8	7.6 2006
Indonesia	+6.3 Q2	na	+6.3	+6.2	+3.6 Jun	+6.5 Aug	+14.9	+5.8	9.8 Feb
Malaysia	+5.7 Q2	na	+5.9	+5.7	+2.1 Jul	+1.6 Jul	+4.1	+2.1	3.4 Q1
Pakistan	+6.6 2006§§	na	+6.4	+5.8	+6.0 Jun	+6.5 Aug	+8.9	+6.5	6.2 2006‡
Singapore	+8.6 Q2	+14.0	+6.2	+4.4	+21.6 Jul	+2.6 Jul	+1.1	+0.9	2.4 Q2
South Korea	+4.9 Q2	+7.0	+4.7	+5.1	+14.3 Jul	+2.0 Aug	+2.7	+2.4	3.2 Aug
Taiwan	+5.1 Q2	na	+4.4	+4.6	+13.0 Jul	+1.6 Aug	−0.6	+0.9	3.9 Jul
Thailand	+4.4 Q2	+5.2	+4.2	+4.8	+7.2 Jul	+1.1 Aug	+3.8	+2.3	1.6 Jun
Argentina	+8.0 Q1	+4.1	+7.3	+5.5	+2.3 Jul	+8.7 Aug	+10.7	+9.1	8.5 Q2‡‡
Brazil	+4.3 Q1	+3.2	+4.6	+4.3	+6.8 Jul	+4.2 Aug	+3.8	+3.5	9.5 Jul‡‡
Chile	+6.1 Q2	+6.5	+5.9	+5.3	+4.0 Jul	+4.7 Aug	+3.8	+3.3	7.0 Jul†††‡‡
Colombia	+8.1 Q1	+10.3	+6.4	+5.1	+11.9 Jun	+5.2 Aug	+4.7	+5.7	11.1 Jun‡‡
Mexico	+2.8 Q2	+5.3	+3.1	+3.4	+0.1 Jun	+4.0 Aug	+3.5	+3.9	4.0 Jul‡‡
Venezuela	+8.9 Q2	na	+5.6	+3.9	+11.2 Jun	+15.9 Aug	+14.9	+18.7	8.4 Q2‡‡
Egypt	+7.4 Q1	na	+7.0	+7.2	+10.5 2006	+8.5 Aug	+8.9	+8.4	9.0 Q1‡‡
Israel	+4.4 Q2	+6.1	+5.1	+4.5	+1.3 Jun	+0.3 Jul	+2.4	+0.3	7.6 Q2
Saudi Arabia	+4.3 2006§	na	+4.0	+5.7	na	+3.8 Jul	+2.2	+3.0	na
South Africa	+5.0 Q2	+4.5	+4.8	+5.2	+3.1 Jul	+7.0 Jul	+5.0	+5.8	25.5 Sep2006‡‡
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+7.3 Q2	na	+7.9	+5.8	+4.4 Jul	+5.7 Aug	+5.0	+6.0	5.1 Jun
Finland	+4.7 Q2	+3.8	+3.9	+2.7	+0.5 Jul	+2.6 Jul	+1.9	+1.4	6.9 Jul
Iceland	−0.1 Q1	−3.6	+1.2	+1.6	+7.6 2006	+3.4 Aug	+8.6	+4.8	0.9 Jul‡‡
Ireland	+7.5 Q1	+20.1	+4.8	+3.4	+13.9 Jul	+5.0 Jul	+4.2	+4.7	4.7 Aug
Latvia	+11.3 Q2	na	+9.6	+7.5	+1.8 Jul	+10.1 Aug	+6.8	+8.3	5.7 Jun
Lithuania	+8.0 Q2	+8.2	+7.8	+6.9	na	+5.1 Jul	+4.4	+4.6	2.8 Jul
Luxembourg	+6.2 Q1	+6.6	+5.2	+4.2	+4.0 Jun	+1.9 Aug	+2.8	+2.2	4.1 Jul‡‡
New Zealand	+2.7 Q1	+2.5	+2.8	+3.1	nil Q1	+2.0 Q2	+4.0	+2.4	3.6 Q2
Peru	+6.7 Jun	na	+7.1	+5.5	+9.7 Jun	+2.2 Aug	+1.9	+1.2	7.6 Jun‡‡
Philippines	+7.5 Q2	+7.1	+6.0	+5.6	−4.7 Jun	+2.4 Aug	+6.3	+2.9	7.4 Q2‡‡
Portugal	+1.6 Q2	+1.7	+1.8	+2.1	+1.0 Jul	+2.4 Jul	+3.0	+2.4	7.9 Q2‡‡
Slovakia	+9.4 Q2	na	+8.0	+6.0	+18.9 Jul	+2.3 Aug	+5.1	+2.7	8.3 Jul
Slovenia	+5.9 Q2	nil	+5.6	+4.6	+8.9 Jul	+3.5 Aug	+3.2	+3.0	7.5 Jun‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 3.8% in Jul. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Sep 13th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Sep 4th	Sep 11th*	% change on one month	% change on one year
Dollar index				
All items	203.6	205.1	+1.1	+20.4
Food	184.9	188.8	+6.9	+42.3
Industrials				
All	227.7	226.1	–4.5	+3.2
Nfa†	160.9	159.1	–1.4	+14.6
Metals	264.3	262.7	–5.4	–0.1
Sterling index				
All items	153.6	153.2	–0.3	+11.2
Euro index				
All items	138.5	137.1	–0.8	+10.4
Gold				
$ per oz	680.20	706.00	+5.6	+18.9
West Texas Intermediate				
$ per barrel	75.09	78.23	+8.1	+22.7

*Provisional †Non-food agriculturals.

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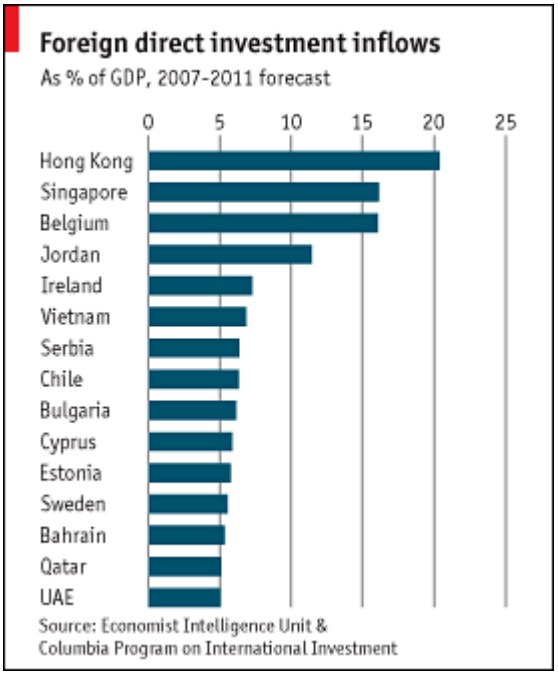
Foreign direct investment inflows

Sep 13th 2007
From The Economist print edition

Infographics



America, Britain and China are set to remain the top destinations for foreign direct investment (FDI) over the next five years, according to a new report from the Economist Intelligence Unit, a sister company of *The Economist*. The report's forecasts, based in part on a global survey of 602 executives, puts the combined share of these large economies at 30% of global FDI flows between 2007 and 2011. Many smaller countries punch much further above their weight in attracting overseas investors. As a share of GDP, Hong Kong and Singapore can expect the biggest FDI inflows. New members of the European Union, such as Bulgaria and Romania, are also attractive to investors seeking low-cost access to the single market.

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Trade, exchange rates, budget balances and interest rates

Sep 13th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†‡	Currency units, per $ Sep 12th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−823.4 Jun	−803.4 Q1	−5.7	–	–	−1.3	5.68	4.40
Japan	+93.2 Jul	+192.6 Jun	+4.4	114	118	−2.9	0.72	1.50
China	+244.9 Aug	+249.9 2006	+10.7	7.52	7.95	−0.7	3.36	4.38
Britain	−158.6 Jul	−93.0 Q1	−3.3	0.49	0.53	−2.7	6.38	4.88
Canada	+47.9 Jul	+21.9 Q2	+1.6	1.04	1.12	0.6	3.92	4.32
Euro area	+24.1 Jun	+3.6 Jun	nil	0.72	0.79	−0.6	4.75	4.09
Austria	+1.1 Jun	+13.2 Q1	+2.9	0.72	0.79	−0.8	4.75	4.28
Belgium	+18.1 Jun	+12.5 Mar	+2.2	0.72	0.79	−0.1	4.82	4.31
France	−40.1 Jul	+15.7 Jun	−1.2	0.72	0.79	−2.5	4.75	4.24
Germany	+219.2 Jun	+192.3 Jul	+5.1	0.72	0.79	0.4	4.75	4.12
Greece	−47.8 Jun	−34.2 Jun	−8.6	0.72	0.79	−2.4	4.75	4.44
Italy	−18.7 Jun	−50.3 Jun	−2.3	0.72	0.79	−2.6	4.75	4.42
Netherlands	+49.0 Jul	+53.5 Q2	+7.9	0.72	0.79	0.6	4.75	4.25
Spain	−121.0 Jun	−119.7 May	−8.8	0.72	0.79	2.1	4.75	4.27
Czech Republic	+3.1 Jul	−5.0 Jun	−4.1	19.8	22.5	−4.2	3.46	4.47
Denmark	+4.8 Jul	+4.7 Jul	+2.1	5.36	5.88	3.8	4.85	4.25
Hungary	−1.9 Jul	−6.2 Q1	−5.2	183	216	−6.0	7.73	6.60
Norway	+54.0 Jul	+54.6 Q2	+14.9	5.63	6.61	16.8	5.63	4.65
Poland	−8.1 Jun	−11.5 Jun	−3.0	2.72	3.12	−2.3	5.09	5.72
Russia	+125.1 Jul	+77.7 Q2	+6.8	25.4	26.8	3.0	10.00	6.33
Sweden	+19.4 Jul	+29.7 Q2	+6.8	6.68	7.30	2.4	3.57	4.09
Switzerland	+11.1 Jul	+102.1 Q1	+16.1	1.18	1.25	0.3	2.90	2.73
Turkey	−55.6 Jul	−33.2 Jul	−6.2	1.27	1.47	−2.9	18.86	6.91§
Australia	−11.7 Jul	−47.1 Q2	−5.4	1.19	1.33	1.3	7.10	5.84
Hong Kong	−20.0 Jul	+23.8 Q1	+10.9	7.79	7.78	1.8	4.93	4.14
India	−67.9 Jul	−9.6 Q1	−1.4	40.4	46.2	−3.3	7.04	8.26
Indonesia	+42.2 Jul	+10.3 Q1	+2.2	9,408	9,113	−1.6	8.18	6.81§
Malaysia	+28.8 Jul	+25.9 Q1	+14.3	3.49	3.67	−3.1	3.62	5.06§
Pakistan	−13.6 Aug	−6.8 Q1	−4.1	60.7	60.5	−4.6	9.72	8.85§
Singapore	+37.0 Jul	+41.6 Q2	+24.0	1.51	1.58	0.3	2.78	2.90
South Korea	+20.0 Aug	+6.9 Jul	+0.3	933	959	0.5	5.34	5.38
Taiwan	+14.3 Aug	+28.3 Q2	+5.8	33.1	32.9	−1.9	2.55	2.52
Thailand	+9.5 Jul	+11.5 Jul	+3.2	34.2	37.4	−1.9	3.55	4.17
Argentina	+10.7 Jul	+7.8 Q1	+3.4	3.14	3.11	1.3	14.44	na
Brazil	+44.1 Aug	+11.5 Jul	+0.7	1.91	2.17	−2.3	11.18	6.16§
Chile	+24.4 Aug	+8.3 Q2	+3.6	515	538	8.0	5.76	5.32§
Colombia	−1.5 Jun	−4.1 Q1	−3.0	2,184	2,406	−0.8	8.96	6.38§
Mexico	−0.8 Jul	−7.0 Q2	−1.0	11.1	11.0	0.1	7.20	7.77
Venezuela	+23.8 Q2	+20.4 Q2	+9.3	2,147	2,696	−3.1	11.12	6.55§
Egypt	−14.1 Q1	+3.1 Q1	+2.3	5.66	5.74	−5.6	7.59	5.25§
Israel	−9.0 Aug	+8.1 Q1	+3.5	4.09	4.38	−1.1	4.30	5.44
Saudi Arabia	+146.6 2006	+98.9 2006	+24.0	3.75	3.75	19.2	5.09	na
South Africa	−9.2 Jul	−16.6 Q1	−6.2	7.15	7.35	0.5	10.10	8.69
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.1 Jun	−3.0 Jun	−16.3	11.3	12.3	3.2	5.21	na
Finland	+12.3 Jun	+12.1 Jun	+6.2	0.72	0.79	4.2	4.70	4.24
Iceland	−1.8 Aug	−3.7 Q2	−16.7	64.3	70.6	3.7	14.13	na
Ireland	+36.0 Jun	−10.6 Q1	−5.1	0.72	0.79	1.0	4.75	4.22
Latvia	−7.0 Jul	−5.7 Jun	−22.2	0.50	0.55	nil	9.00	na
Lithuania	−6.5 Jul	−4.2 Jun	−12.9	2.49	2.72	−0.5	5.62	na
Luxembourg	−5.6 Jun	+4.5 Q1	na	0.72	0.79	0.3	4.75	na
New Zealand	−4.4 Jul	−9.1 Q1	−9.8	1.41	1.55	4.9	7.20	6.01
Peru	+9.1 Jun	+2.8 Q2	+1.9	3.15	3.25	0.4	5.00	na
Philippines	−3.4 Jun	+5.7 Mar	+5.1	46.7	50.4	−1.1	7.13	na
Portugal	−23.3 Jun	−18.0 Jun	−8.2	0.72	0.79	−3.3	4.75	4.40
Slovakia	−2.1 Jun	−3.5 May	−4.5	24.2	29.5	−2.9	4.11	4.53
Slovenia	−2.4 Jul	−1.5 Jun	−2.6	0.72	0.79	−1.2	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Sep 13th 2007
From The Economist print edition

Markets

	Index Sep 12th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,291.7	–0.1	+6.6	+6.6
United States (S&P 500)	1,471.6	nil	+3.8	+3.8
United States (NAScomp)	2,592.1	–0.5	+7.3	+7.3
Japan (Nikkei 225)	15,797.6	–2.2	–8.3	–4.3
Japan (Topix)	1,528.3	–2.6	–9.1	–5.1
China (SSEA)	5,430.8	–2.6	+92.9	+100.2
China (SSEB, $ terms)	328.0	–0.1	+142.9	+152.1
Britain (FTSE 100)	6,306.2	+0.6	+1.4	+5.2
Canada (S&P TSX)	13,756.7	+0.5	+6.6	+19.5
Euro area (FTSE Euro 100)	1,320.9	–0.9	+3.3	+8.8
Euro area (DJ STOXX 50)	4,210.7	–0.6	+2.2	+7.6
Austria (ATX)	4,472.8	–2.4	+0.2	+5.5
Belgium (Bel 20)	4,255.7	–1.5	–3.0	+2.1
France (CAC 40)	5,508.0	–0.8	–0.6	+4.7
Germany (DAX)*	7,473.0	–1.5	+13.3	+19.3
Greece (Athex Comp)	4,823.0	–0.7	+9.8	+15.6
Italy (S&P/MIB)	39,004.0	–0.9	–5.9	–0.9
Netherlands (AEX)	523.4	+0.1	+5.7	+11.3
Spain (Madrid SE)	1,543.3	–1.8	–0.8	+4.5
Czech Republic (PX)	1,755.7	–2.8	+10.5	+16.3
Denmark (OMXCB)	462.7	–2.1	+9.1	+15.0
Hungary (BUX)	26,960.4	–1.3	+8.5	+13.0
Norway (OSEAX)	552.6	–0.7	+10.0	+21.6
Poland (WIG)	59,619.7	–1.3	+18.3	+26.2
Russia (RTS, $ terms)	1,900.0	–0.3	–4.6	–1.1
Sweden (Aff.Gen)	371.7	–3.3	+1.8	+4.2
Switzerland (SMI)	8,784.0	–0.7	nil	+3.0
Turkey (ISE)	49,233.1	–0.4	+25.9	+39.9
Australia (All Ord.)	6,236.0	–0.6	+10.5	+17.8
Hong Kong (Hang Seng)	24,310.1	+1.0	+21.8	+21.6
India (BSE)	15,505.4	+0.4	+12.5	+23.1
Indonesia (JSX)	2,209.9	–0.2	+22.4	+17.0
Malaysia (KLSE)	1,285.9	–0.9	+17.3	+18.5
Pakistan (KSE)	12,784.0	+0.9	+27.3	+27.8
Singapore (STI)	3,506.1	+1.8	+17.4	+19.0
South Korea (KOSPI)	1,813.5	–2.8	+26.4	+26.1
Taiwan (TWI)	9,018.1	+1.2	+15.3	+13.6
Thailand (SET)	802.0	–1.5	+18.0	+24.5
Argentina (MERV)	2,008.7	–2.5	–3.9	–6.2
Brazil (BVSP)	53,882.0	–1.0	+21.2	+35.1
Chile (IGPA)	14,162.8	–3.5	+14.5	+18.3
Colombia (IGBC)	10,647.7	–1.6	–4.6	–2.2
Mexico (IPC)	30,076.3	–2.4	+13.7	+11.2
Venezuela (IBC)	39,223.4	–1.2	–24.9	+16.9
Egypt (Hermes)	73,686.6	+2.1	+20.2	+21.4
Israel (TA-100)	1,025.8	–2.2	+11.3	+14.6
Saudi Arabia (Tadawul)	7,807.9	–0.6	–1.6	–1.6
South Africa (JSE AS)	28,730.2	+0.1	+15.3	+13.7
Europe (FTSEurofirst 300)	1,510.3	–0.8	+1.8	+7.2
World, dev'd (MSCI)	1,559.5	+0.2	+5.1	+5.1
Emerging markets (MSCI)	1,089.7	+0.4	+19.4	+19.4
World, all (MSCI)	391.1	+0.2	+6.3	+6.3
World bonds (Citigroup)	699.9	+1.6	+6.3	+6.3
EMBI+ (JPMorgan)	415.8	+0.7	+2.1	+2.1
Hedge funds (HFRX)	1,310.7	–0.1	+2.7	+2.7
Volatility, US (VIX)	25.0	24.6	11.6	(levels)
CDSs, Eur (iTRAXX)†	52.3	+8.9	+124.3	+136.2
CDSs, N Am (CDX)†	72.4	+4.1	+116.6	+116.6
Carbon trading (EU ETS) €‡	21.00	+3.0	+15.2	+21.3

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡New series.

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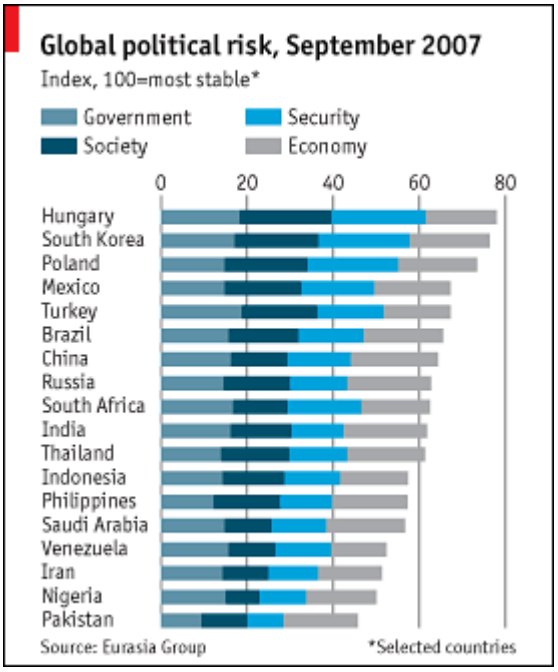
Global political risk, September 2007

Sep 13th 2007
From The Economist print edition



Emerging markets yearn to be boring, at least politically. The Global Political Risk Index, which is produced by Eurasia Group, a think tank, rates Hungary just in front of South Korea as the most stable country in a 24-strong field. The index uses a range of qualitative and quantitative indicators to measure both the capacity of countries to withstand shocks and their susceptibility to internal crises. Pakistan comes bottom of the list, because of mounting political and security tensions, and Eurasia Group is not expecting things to improve. Nigeria and Iran also jostle at the foot of the table. But stability should not be confused with pluralism: China outranks South Africa, India and some other democracies.

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